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TELECOMMUNICATIONS ACT OF 1982
(Part 1)

ORIGINAL

COMPLETED

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE

OF THE

COMMITTEE ON ENERGY AND COMMERCE HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 5158

A BILL TO AMEND THE COMMUNICATIONS ACT OF 1934 TO REVISE PROVISIONS OF THE ACT RELATING TO TELECOMMUNICATIONS, AND FOR OTHER PURPOSES

FEBRUARY 2, 9, 11, 17, AND 18, [illegible]

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IMPACT ON RATEPAYERS

TUESDAY, FEBRUARY 2, 1982

House of Representatives,
Subcommittee on Telecommunications,
Consumer Protection, and Finance,
Committee on Energy and Commerce,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2123, Rayburn House Office Building, Hon. Timothy E. Wirth (chairman) presiding.

Mr. Wirth. The subcommittee will come to order. Perhaps we might want to use some of these seats at the end of the diocese here for people who are waiting outside. I want to thank you all for being here this morning. Today we hold hearings on the customer impact of both H.R. 5158, the Telecommunications Act of 1981, and the proposed A.T. & T. antitrust settlement.

I am delighted to welcome here this morning 11 distinguished State public utility commissioners from around the country who have been willing to give up their valuable time to come here today and explore with us the effect that legislation and the proposed consent decree would have on the welfare of the local customer.

I have consistently stated that any telecommunications reform legislation must not only encourage competition in the telecommunications industry, but must also serve the needs of the Nation's customers and broader users of telecommunications and telephone service.

Maintenance and improvement of the universal availability of telecommunications services at an affordable level is a central focus of H.R. 5158. This issue has become even more critical in light of the proposed antitrust settlement, which clearly leaves unanswered many key questions relating to the continued provision of the phone service at reasonable rates.

State utility commissions, with their intimate knowledge of the telecommunications industry in their respective States, must play a crucial role both during and after the transition of this industry to a more fully competitive environment. The proposed consent decree leaves totally unsettled what role the State commissions should play in the future regulation of the telecommunications industry.

I would like to thank those PUC chairmen and commissioners here today, as well as others throughout the country, for their dedicated efforts in working to help us to fashion legislation which will shield the local ratepayer from the adverse impact that might otherwise ensue—which some of the State PUC's have estimated might well involve at least a doubling of telephone rates in the near term.

One issue with which I am particularly concerned is maintaining the future viability of the spun-off operating companies so that they are not relegated to offering the most labor- and capital-intensive, and least profitable, services. In this regard it becomes very important to ascertain who, if anyone, is protecting the interests of the soon-to-be-independent Bell operating companies where it is possible that their interests diverge from those of the A.T. & T. parent. It is crucial to the customers of this country that the interests of the two be both advocated and safeguarded during these and various other deliberations.

Without objection the text of H.R. 5158 will be printed at this point in the record.

[Testimony resumes on p. 123.]

[The text of H.R. 5158 follows:]

97TH CONGRESS
1ST SESSION

H. R. 5158

To amend the Communications Act of 1934 to revise provisions of the Act relating to telecommunications, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 10, 1981

Mr. WIRTH introduced the following bill; which was referred to the Committee on Energy and Commerce

---

A BILL

To amend the Communications Act of 1934 to revise provisions of the Act relating to telecommunications, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Telecommunications Act of 1981".

TITLE I—GENERAL PROVISIONS

PURPOSES OF ACT

SEC. 101. Section 1 of the Communications Act of 1934 is redesignated as section 101, and is amended—

(1) by inserting "(a)" after the section designation;

(2) by striking out "For" and all that follows through "there" and inserting in lieu thereof "There"; and

(3) by adding at the end thereof the following new subsection:

"(b) The purposes of this Act shall be—

"(1) to make available to all the people of the United States efficient nationwide and worldwide telecommunications at reasonable and affordable charges;

"(2) to rely, whenever possible, on competition, rather than regulation, to determine the variety, quality, and cost of telecommunications, and to promote the development of such competition;

"(3) to maintain and improve universal telecommunications services which are vital to the national economy;

"(4) to support the national defense, emergency preparedness, and the safety of life and property through the use of telecommunications;

"(5) to encourage the entry of new competitors and the development and use of new technologies to increase the variety and efficiency of telecommunications services and facilities;

"(6) to maximize efficient utilization of the electromagnetic spectrum;

"(7) to promote a diversity of information sources;

"(8) to advance the technological and commercial leadership of United States suppliers of telecommunications in domestic and foreign markets;

"(9) to ensure that the users of regulated telecommunications services and facilities pay only reasonable and nondiscriminatory charges and that such charges do not include the costs of competitive activities of carriers;

"(10) to encourage cooperation between the Federal Government and the States in regulating telecommunications carriers, to recognize the appropriate jurisdictional authority of the States, and to utilize effectively the regulatory expertise of State commissions; and

"(11) to promote interstate and foreign commerce.".

APPLICATION OF ACT

SEC. 102. Section 2 of the Communications Act of 1934 is amended to read as follows:

"APPLICATION OF ACT

"SEC. 102. The provisions of this Act shall apply to—

"(1) all interexchange and international transmissions and to all persons engaged in the United States in the provision of transmissions, subject to the limitations of, and consistent with the purposes established in, title II;

"(2) exchange transmissions, to the extent that the authority to regulate such transmissions is not delegated to the States in title II;

"(3) all transmissions of energy by radio which originate or are received in the United States; and

"(4) the allocation and use of the electromagnetic spectrum.".

TITLE II—INTEREXCHANGE AND INTERNATIONAL TRANSMISSIONS

REVISION OF TITLE II OF COMMUNICATIONS ACT OF 1934

SEC. 201. (a) Title II of the Communications Act of 1934 is amended by striking out the heading for such title, and by striking out sections 201(b), 202, 203, 204, 205, 216, 219, 220(a), 221, and 224(e).

(b) The Communications Act of 1934 is amended by inserting after title I the following:

"TITLE II—INTEREXCHANGE AND INTERNATIONAL TRANSMISSIONS

"DECLARATION OF PURPOSES

"SEC. 201. (a) It is the purpose of this title to guarantee that the people of the United States have available, at reasonable and affordable rates, domestic and international transmission services and facilities which are reliable, efficient, and diverse, and to assure that the economy, general welfare, and security of the United States will benefit from continuing improvements in telecommunications technology. In achieving such purpose, marketplace forces, rather than regulation, shall be relied upon to the maximum extent possible to determine the variety, quality, and cost of transmission services and facilities.

"(b)(1) Where marketplace forces cannot be relied upon to achieve the purposes of this title, or where the continuance of competition is in doubt, the Commission shall encourage competition to the maximum extent possible.

"(2) The absence of adequate alternatives in a telecommunications market shall not be used to reduce or eliminate competition in other related markets. The costs of competitive activities of carriers shall not be borne by the users of the services or facilities of such carriers for which there are not adequate alternatives.

"(c) In the exercise and performance of its powers and duties under this title, the Commission shall—

"(1) promote universal availability of transmission services and facilities at reasonable and affordable rates;

"(2) establish competitive conditions;

"(3) promote and rely upon competition to provide efficiency, innovation, and reasonable rates for telecommunications services and facilities;

"(4) place maximum possible reliance on marketplace forces;

"(5) prevent practices which would allow any carrier to limit or exclude competition in the provision of telecommunications services, facilities, or products;

"(6) support the national defense, emergency preparedness, and the safety of life and property through the use of telecommunications; and

"(7) advance the technological and commercial leadership of United States suppliers of telecommunications in domestic and foreign markets.

"(d) The Commission shall exercise only so much of the powers conferred upon it under this title as is necessary to carry out the purposes of this Act, and shall revise, reduce, or eliminate any rule prescribed under this title with respect to (1) any transmission service or facility as competition develops, such that the need for regulation diminishes; or (2) any carrier which does not have the ability to affect significantly any market price.

"PART A—REGULATORY AUTHORITY OF COMMISSION

"SCOPE OF REGULATORY AUTHORITY

"SEC. 211. (a) Subject to the provisions of this Act, the Commission shall have authority regarding—

"(1) electronic transmissions and any other activities of a carrier, to the extent such activities affect, or are affected by, the provision of transmission services by such carrier; and

"(2) the activities of any person (other than a carrier), to the extent such activities directly affect the provision of electronic transmissions.

"(b) Neither the Commission nor any State commission shall consider the revenues or profits associated with the offering of any unregulated products or services by any affiliate or separate subsidiary of a regulated carrier in determining the revenue requirements of any regulated service of such carrier unless such carrier has filed a tariff with the Commission or such State commission including any cost associated with the provision of any unregulated service or product.

"(c) Neither the Commission nor any State may impose or enforce any condition restricting the resale or shared use of any transmission service or enhanced service.

"(d) Neither the Commission nor any State shall have any authority to regulate the acquisition, processing, or marketing of information or any other service or product for the processing of data, including any service providing remote access, which uses telecommunications in the provision of such service, other than to the extent regulation of such a service when offered by a regulated carrier may be specifically required under this title.

"CLASSIFICATION OF CARRIERS AND SERVICES; REVIEW OF CLASSIFICATIONS

"SEC. 212. (a)(1) The Commission, in accordance with the provisions of this section, shall classify all carriers which own interexchange transmission facilities as dominant carriers, regulated carriers, or deregulated carriers.

"(2) The Commission shall complete its initial classification under paragraph (1) not later than 6 months after the effective date of this section.

"(3) Any carrier classified as a deregulated carrier in the initial classification made by the Commission under paragraph (1) shall continue offering services which were previously subject to regulation for not less than 90 days after such classification.

"(4) The Commission, upon a request submitted by any person, may classify any new carrier, new facility, or new service in accordance with the provisions of this section. Such classification shall be completed not later than 90 days after the date of such request.

"(5) The Commission may, upon its own motion or upon petition by any person, review the classification of any carrier, facility, or service made by the Commission under this section.

"(6) Any classification or review by the Commission under this section shall be carried out in accordance with such procedures as the Commission may establish by rule.

"(b)(1) The Commission shall classify a carrier as a dominant carrier if the Commission determines that—

"(A) on a nationwide basis, the carrier owns a majority of the facilities used to support the transmission of exchange and interexchange telecommunications; and

"(B) adequate alternative facilities are not available on a nationwide basis from unaffiliated carriers.

"(2) Any carrier classified as a dominant carrier under paragraph (1) shall be subject to the requirements of this Act applicable to dominant carriers, regulated carriers, and interexchange carriers, and shall continue to be classified as a dominant carrier until the Commission determines that the criteria established in paragraph (1) no longer apply to such carrier.

"(c) The Commission shall classify an interexchange carrier as a regulated carrier if the Commission determines that such carrier offers a regulated service, and such carrier shall continue to be so classified until the Commission determines that such carrier no longer offers any regulated service.

"(d)(1) The Commission shall classify an interexchange transmission service offered by any carrier as a regulated service if the Commission determines that—

"(A) such transmission service was offered on January 1, 1982, by any carrier which, as of such date, participated in the system of jurisdictional separation of carrier property and expenses established under section 410(c);

"(B) there are not adequate alternative facilities for the provision of such transmission service available from unaffiliated carriers to offer similar services; or

"(C) such transmission service is provided, in substantial part, through the use of facilities which such carrier uses to provide any service specified in subparagraph (A) or (B).

"(2) Any service classified as a regulated service under subparagraph (A) or (B) of paragraph (1) shall continue to be so classified until the Commission determines that adequate alternative facilities to offer similar services are available from unaffiliated carriers.

"(e) A regulated carrier (other than a dominant carrier) offering a regulated service also may offer a transmission service (which is provided in whole or in part through the use of the same facilities which are used to provide regulated service) on an unregulated basis only if the Commission determines that—

"(1) unaffiliated deregulated carriers and resellers are providing service which is comparable in quality, economic cost, and geographic range; and

"(2) there are sufficient offerings of such service by unaffiliated deregulated carriers and resellers to ensure that any cost of providing such service is not borne by the users of regulated services.

"(f) The Commission, for purposes of adjusting its regulatory supervision to prevailing market and industry developments and conditions, may by rule establish additional criteria to be used in classifying carriers under this section. The Commission may establish subcategories of regulated carriers and criteria applicable to such subcategories, which shall be consistent with—

"(1) the distinctions among dominant carriers, regulated carriers, and deregulated carriers; and

"(2) the criteria set forth in this section.

"(g) The Commission shall provide an opportunity for a hearing to any carrier classified as a dominant carrier or regulated carrier under this section if such carrier seeks to contest such classification.

"DETERMINATION OF ADEQUACY OF ALTERNATIVE FACILITIES

"SEC. 213. For purposes of providing for the regulation or deregulation of any transmission service or facility under this title, alternative transmission facilities shall not be considered to be adequate alternatives to any transmission facilities unless the alternative facilities—

"(1) provide service which is comparable in quality, economic cost, and geographic range; and

"(2) have sufficient capacity to ensure competitive pricing in the absence of regulation.

"INTERCONNECTION

"SEC. 214. (a) Any carrier, and any business entity which owns or offers inside wiring, shall—

"(1) promptly provide interconnection, upon reasonable request, to any transmission service or facility, or any terminal equipment, which meets such technical standards as the Commission may establish by rule; and

"(2) furnish such technical information (including protocols) as may be necessary to provide effective and efficient interconnection.

"(b) Carriers and other persons required to provide interconnection by subsection (a) shall not discriminate in an unreasonable or anticompetitive manner with respect to rates, terms, and conditions for such interconnection.

"(c)(1) The Commission shall have authority (A) to enforce the provisions of this section; and (B) to specify or to approve the manner, rates, terms, and conditions for the provision of interconnection to regulated interexchange and exchange services or facilities in accordance with sections 222, 223, 232, and 242. The Commission may waive the requirements of this section in the case of small business entities which own or offer inside wiring.

"(2) Any person aggrieved by any alleged violation of this section may submit a complaint to the Commission.

"PART B—INTEREXCHANGE TRANSMISSION

"ESTABLISHMENT OF CARRIER REQUIREMENTS

"SEC. 221. (a) Consistent with the purposes of this title, and based upon the level of competition in the markets involved, the Commission may prescribe different requirements for—

"(1) different subcategories of regulated carriers established by the Commission under section 212(f);

"(2) different transmission facilities or services; or

"(3) various combinations of carriers, facilities, and services;

except that the Commission may not prescribe different requirements for different carriers if the characteristics and activities of such carriers are substantially similar.

"(b)(1) With respect to regulated carriers, the Commission may prescribe such conditions governing the provision of any interexchange service as may be necessary to ensure that the provision of such service by such carriers is consistent with the purposes of this title.

"(2) Such conditions shall be designed to assure the universal availability of transmission services at reasonable and affordable rates, to prevent anticompetitive practices, and to ensure that users of services for which there are not adequate alternatives do not bear costs associated with competitive offerings.

"REQUIREMENTS APPLICABLE TO INTEREXCHANGE CARRIERS

"SEC. 222. (a) No carrier may impose or enforce any condition restricting the resale or shared use of any transmission service or enhanced service.

"(b) All interexchange carriers shall provide interconnection to any transmission service or facility or any terminal equipment in accordance with the requirements of section 214.

"(c) No carrier shall offer interexchange service (other than any resale of an interexchange service) until the end of the 30-day period after it notifies the Commission that it intends to provide such service. The notice shall contain such information as the Commission may require regarding the ownership, nature, and quality of the service to be offered. The Commission may not limit or prohibit any service during the 30-day period following such notice unless such action is necessary to prevent any unfair, deceptive, or anticompetitive practices.

"(d)(1) No interexchange carrier shall terminate or suspend any interexchange service which it is providing unless the carrier gives the Commission, any affected customers, and the State commission involved notice of its intent to terminate or suspend such service at least 60 days before such action.

"(2) The Commission shall permit any such carrier to terminate or suspend the offering of any regulated service which does not meet the criteria of subparagraph (A) or (B) of section 212(d)(1).

"(3) If any such service is not a regulated service at the time the carrier involved submits such notice, or if the Commission permits the termination or suspension of such service under paragraph (2), any person may petition the Commission to review the classification of such service under section 212. The Commission may require the carrier to continue to offer service for an additional period of not to exceed 60 days if the Commission determines that further investigation or a public hearing is necessary to review the classification of the service intended to be terminated.

"(e) Any person which intends to offer or to terminate resale of any interexchange service shall submit written notice to the Commission of such intent not later than the date on which such person commences or terminates the offering of such service.

"(f) The Commission may obtain from any carrier, any person engaging in the resale of telecommunications services, or any other person full and complete information (including annual reports, in the case of interexchange carriers) necessary to enable the Commission—

"(1) to perform and carry out its responsibilities under this Act;

"(2) to evaluate the extent of competition in various markets for interexchange telecommunications services (including markets for the resale of such services); and

"(3) to keep informed as to technical developments and improvements in telecommunications.

"REQUIREMENTS APPLICABLE TO REGULATED CARRIERS

"SEC. 223. (a) It shall be the duty of every regulated carrier to furnish regulated services to any person upon any reasonable request.

"(b)(1) Carriers which provide regulated services shall establish just, reasonable, and nondiscriminatory tariffs for such services in accordance with section 226. Such tariffs shall (A) provide customers with as wide a range of qualities, options, capabilities, prices, and geographic range as is practical; and (B) permit customers to obtain such access to each of the components and segments of services as is practical. The charge for any such component or segment of service shall include all costs associated with such component or segment, and shall not result in any increase in the charge for any other regulated service.

"(2) Any such tariff which is unjust or unreasonable or which results in any undue or unreasonable discrimination, preference, or advantage with respect to any person, class of persons, or locality with respect to like services, shall be unlawful.

"(3) Upon reasonable request, a carrier shall file with the Commission to modify any tariff to provide any variation in a regulated service required by paragraph (1).

"(c) No tariff for any regulated service may include any costs associated with—

"(1) the participation of a regulated carrier in markets for products or services other than electronic transmission; or

"(2) the provision of other transmission services, regardless of whether such services are regulated.

"(d) Every regulated carrier shall file with the Commission copies of all contracts, agreements, or arrangements between the regulated carrier and any other carrier, if such contract, agreement, or arrangement relates to any telecommunications service, facility, or equipment subject to regulation under this Act. The Commission may require any carrier to file other types of contracts with the Commission, and also may exempt any carrier from filing copies of such minor contracts as the Commission may determine.

"VALUATION OF CARRIER PROPERTY; DEPRECIATION CHARGES

"SEC. 224. [Reserved.]

"EXTENSION OF FACILITIES; TRANSACTIONS REGARDING SERVICES AND EQUIPMENT

"SEC. 225. [Reserved.]

"TARIFFS

"SEC. 226. (a)(1) No new or revised tariff proposed after the effective date of this section by any regulated carrier for regulated services (including interconnection arrangements under section 214) shall take effect until it has been accepted, or accepted with conditions, by the Commission. Any tariff rejected by the Commission shall have no effect, and the tariff previously in effect for the same or similar service shall remain in effect.

"(2) The provisions of this section shall not apply to any tariff filed with the Commission or any State commission before January 1, 1982, unless the Commission determines otherwise.

"(b)(1) Any regulated carrier proposing a new or revised tariff shall file all material data regarding costs and projections of revenues which establish the justness and reasonableness of such tariff and such other pertinent information as the Commission may by rule require.

"(2)(A) The Commission, upon receiving any proposed tariff, shall provide public notice and an opportunity for public comment during the 30-day period following such notice. The Commission may set forth specific requirements for additional information or justification from the carrier proposing such tariff. As soon as practicable, but in any event not later than 90 days after the date of filing of such tariff, the Commission shall make an initial determination in accordance with paragraph (3). Whenever the Commission has required additional information, it shall extend such period for not more than 90 days.

"(3) The Commission shall—

"(A) accept a tariff as filed;

"(B) condition the acceptance of a tariff upon timely compliance with such requirements as it determines necessary to carry out the purposes of this title;

"(C) reject a tariff (and set forth reasons for such rejection), where it determines that such tariff is unlawful or in substantial conflict with a rule, policy, or order of the Commission, or where it has not satisfied itself, on the basis of the information or justification provided, that such tariff is lawful; or

"(D) prescribe a different tariff, and require timely compliance with any requirements or conditions as it determines necessary to carry out the purposes of this title.

"(c) During the period specified in subsection (b)(2), the Commission may offer assistance to facilitate public negotiation between the carrier proposing the tariff involved and any person opposing the tariff in order to arrive at a mutually agreeable proposal. The Commission shall duly consider any mutually agreeable proposal in deciding whether to accept, accept with conditions, or reject the tariff as proposed, or to prescribe a different tariff.

"(d) Upon timely request and for good cause shown, the Commission shall hold a hearing, as soon as practicable after such request, concerning the lawfulness of the proposed tariff or of the interim prescribed tariff, as the case may be.

"(e) Pending any hearing under subsection (d), any tariff initially accepted or prescribed by the Commission shall have effect and any tariff accepted with conditions by the Commission shall have effect upon compliance with such conditions by the carrier involved.

"(f) Upon completion of any hearing under subsection (d), the Commission shall exercise the authority established in subsection (b)(3). The carrier involved shall adopt any tariff prescribed by the Commission.

"(g) In any proceeding under this section, the burden of proof to show that the proposed tariff complies with section 223(b) shall be upon the proposing carrier. The Commission shall make the required determinations as expeditiously as possible, but in any event not later than 180 days after completion of a hearing.

"(h) Any regulated carrier may file a tariff for joint service with any other regulated carrier, and the Commission may authorize such carriers to divide revenues from the provision of such service. Carriers filing joint tariffs shall not be considered to be affiliates as a result of such filing.

"REQUIREMENTS APPLICABLE TO DOMINANT CARRIERS

"SEC. 227. Any offering of an interexchange telecommunications service by a dominant carrier shall be subject to the requirements established in this part and in part E.

"ENHANCED SERVICES

"SEC. 228. (a) The Commission and State commissions (1) shall not have any authority to regulate the provision of enhanced services by persons other than regulated carriers or regulated exchange carriers; and (2) may regulate the provision of enhanced services by such carriers only to the extent necessary to enforce the requirements of this title.

"(b) Regulated carriers and regulated exchange carriers offering enhanced services and facilities designed for enhanced services shall (1) establish charges for such services and facilities on a separate basis from charges applicable to the provision of any regulated service or regulated facility by such carriers; and (2) establish accounts and records for such enhanced services and facilities on a separate basis from accounts and records applicable to such regulated services or facilities.

"(c) It shall be unlawful for any regulated carrier or any regulated exchange carrier to file any tariff for any regulated service or regulated exchange service which includes any cost associated with the provision of enhanced services or facilities.

"(d) No dominant carrier may provide any enhanced services except through a separate subsidiary which complies with section 252 or 253.

"FRANKS AND PASSES

"SEC. 229. [Reserved.]

"PART C—EXCHANGE TRANSMISSION

"OFFERING OF SERVICE; EXCHANGE AREAS

"SEC. 231. (a) Except as otherwise provided in this title, State commissions shall have exclusive authority to specify the carriers, rates, terms, and conditions for the offering of exchange transmission service.

"(b) Subject to review by the transitional joint board, it shall be the responsibility of each State commission to establish exchange areas within the borders of the State involved in accordance with the requirements established in subsection (c). Any exchange area established as of January 1, 1982, shall be deemed to comply with such requirements.

"(c)(1) Each exchange area established by a State commission shall encompass an area serving common social, economic, and other similar purposes. The boundaries of each exchange area shall be established in a manner which promotes competition in interexchange telecommunications service.

"(2) No State may be a single exchange area. Every point in a State (other than any point not required to be served by any carrier) shall be included in an exchange area. Except with approval of the transitional joint board, no exchange area located in one State may include any point located in another State. No exchange area which includes part or all of one standard metropolitan statistical area may include a substantial part of any other standard metropolitan statistical area, except that the transitional joint board shall allow appropriate exceptions to such requirement in the case of densely populated States.

"(3) Any person aggrieved by any action taken by a State commission under this subsection may submit a petition for review by the transitional joint board. The transitional joint board may modify any exchange area, upon completion of such review, in accordance with section 273(e)(1).

"(d) For purposes of this section, the term 'standard metropolitan statistical area' means the area in and around a city of 50,000 inhabitants or more, as defined by the Secretary of Commerce.

"PROTECTION OF COMPETITIVE CONDITIONS IN DEPENDENT MARKETS

"SEC. 232. (a) Any carrier which offers exchange transmission service for which there are not adequate alternative facilities shall not impede the development of competition in markets for interexchange transmission, terminal equipment, enhanced services, information publishing, or other products and services which depend upon exchange facilities and services or which may be used in conjunction with such facilities and services.

"(b)(1) In accordance with section 233, every exchange carrier shall—

"(A) provide all interexchange carriers with equal interconnection to exchange services and facilities, and treat all such carriers on an equal basis; and

"(B) beginning on September 1, 1985, or beginning 30 days after receiving any written request, whichever occurs later, offer to all interexchange carriers (on an unbundled, tariffed basis) exchange access to any exchange which is equal in type, quality, and range of supporting functions to access provided (i) to the interexchange services of such exchange carrier; and (ii) to the interexchange services of any interexchange carrier which is an affiliate of such carrier.

"(2) The Commission may postpone the application of the requirements of paragraph (1) in the case of any exchange carrier which, together with any affiliated exchange carriers, includes not more than 50,000 main stations and equivalent stations if the Commission determines that such a postponement will avoid undue burdens upon such carrier.

"(3) Until tariffs have been filed for exchange access, no interexchange carrier shall be required to pay more for exchange access than is paid by any other interexchange carrier or other customer for similar services and related functions.

"(c) Every regulated exchange carrier shall allow customers to interconnect to its services and facilities any terminal equipment which meets the technical standards established by the Commission in accordance with section 241.

"(d) In the provision of transmission services and related functions used in connection with terminal equipment, enhanced services, information publishing, and any other product or service, exchange carriers shall not discriminate between affiliated persons (including any separate subsidiary) and unaffiliated persons.

"(e) [Reserved.]

"(f) A State commission may obtain from any carrier, from any person engaging in the resale of telecommunications services, or any other person within the State full and complete information (including annual reports) necessary to enable the State commission to perform and carry out its responsibilities under this Act, and to keep informed as to technical developments and improvements in telecommunications.

"CONTRIBUTIONS FOR UNIVERSAL SERVICE

"SEC. 233. (a) It is the purpose of this section to establish a system of access fees to compensate regulated exchange carriers for the use of their services and facilities by interexchange carriers and other interexchange customers and to reform the jurisdictional separation and settlements procedures established under section 410(c) and in force on the effective date of this section. The purposes of such system of contributions are—

"(1) to achieve equality of treatment among all interexchange carriers and other customers using the services and facilities of each exchange carrier through direct or indirect interconnection for the distribution of interexchange transmissions, and to prevent any subsidy from exchange services or functions to interexchange services or functions of such carriers;

"(2) to assure that payments and assignments of costs relating to access to exchange transmission services and facilities by interexchange carriers and other customers are carried out in a manner which ensures accountability and is open to public examination;

"(3) to achieve flexibility in accommodating changes in market conditions and technology;

"(4) to establish incentives for efficient investment decisions and technological choices;

"(5) to compensate exchange carriers for the costs of distributing interexchange transmissions through the use of exchange services and facilities;

"(6) to ensure the continued universal availability of telecommunications services provided by exchange carriers at reasonable and affordable rates; and

"(7) to encourage the States to promote competition in the provision of exchange services.

"(b)(1) Subject to subsection (c), an exchange carrier shall submit a schedule of fees for each of its exchange areas to the Commission for each service, facility, and any other supporting function provided by such carrier to interexchange carriers and to other customers which interconnect with the facilities of such carrier. The Commission may allow a carrier to file a joint schedule of fees for all of its affiliates within a single State for a period of 6 years after the effective date of this section. If more than one exchange carrier serves an exchange area, such carriers may submit a joint schedule of fees and may divide revenues in a manner approved by the Commission.

"(2) Provision of such services, facilities, and other supporting functions, and payment for them, shall be solely in accordance with schedules of access fees established under this section.

"(3) The Commission, in establishing or approving such fees, shall be bound by the formulas established and maintained by the transitional joint board under section 273(e)(2).

"(c) Each schedule of fees submitted by an exchange carrier under subsection (b) shall consist of, and shall specifically identify—

"(1) all costs caused directly by interconnection and all costs caused directly by the volume of interexchange traffic, reflecting differences in the manner and value of interconnection and the services and facilities requested by and rendered to an interexchange carrier or other customer by such exchange carrier;

"(2) a portion of the other costs of exchange transmission services and facilities associated with both exchange service and the distribution of interexchange transmissions by such exchange carrier, as determined by the transitional joint board under section 273, except that amounts in excess of the cost of the use of exchange transmission facilities determined by the transitional joint board to be necessary to avoid substantial or undue rate increases shall be recovered by eligible carriers from the National Telecommunications Fund, and shall not be recovered by such carriers from access fees; and

"(3) any amount established and maintained under section 234(b)(1), and any amount established and maintained under section 234(c).

"(d) Each schedule of fees submitted by an exchange carrier shall include a certification that—

"(1) such exchange carrier is providing equal interconnection in compliance with the requirements of this section and sections 214 and 232(b)(1); and

"(2) such fees do not include any cost not associated directly with the provision of exchange access.

"(e)(1) The Commission shall accept or reject any schedule of fees submitted by an exchange carrier or prescribe a different schedule in order to ensure that such fees are consistent with the provisions of this section. The Commission may prescribe a schedule of fees on an interim basis which establishes incentives for such carrier to submit a revised schedule of fees which will comply with the requirements of this section. The burden of proof that a schedule of fees complies with this section shall be upon the carrier submitting such schedule.

"(2) The Commission may permit exchange carriers which, together with any affiliated exchange carriers, include not more than 50,000 main stations and equivalent stations to use statistical cost data representative of such class of carriers to support schedules of access fees in lieu of individual cost studies.

"(f) The Commission may delegate to State commissions the authority established in this section with respect to exchange carriers which, together with any affiliated exchange carriers, include not more than 100,000 main stations and equivalent stations. Any such delegation shall be conditional upon the compliance by the State commission with the requirements of this section and with rules and procedures established by the transitional joint board to determine the jurisdictional allocation of plant and operating expenses.

"(g)(1) The initial schedules of fees which are required to be established under subsection (b) shall take effect at the end of the 3-year period following the effective date of this section.

"(2) During the 3-year period following the period specified in paragraph (1), the transitional joint board shall require adjustments which ensure that all carriers and other customers make an equitable and orderly transition from the level of reimbursements made as of the day before the date on which access fees first take effect under this subsection to the level of reimbursement which will be paid under subsection (c) and section 234.

"(h) A State commission may authorize or require exchange carriers within the State to divide revenues received from access fees.

"NATIONAL TELECOMMUNICATIONS FUND

"SEC. 234. (a) The transitional joint board shall establish and administer a National Telecommunications Fund, consisting of the accounts required in this section.

"(b)(1) The National Telecommunications Fund shall include an account consisting of the total amount determined by the transitional joint board to be required annually by eligible exchange carriers to ensure that the costs for the distribution of interexchange service and exchange service per main station or equivalent station which in the aggregate for any such carrier and its affiliates, exceed 110 percent of the national average of such costs will not be borne directly by exchange ratepayers or by access fees.

"(2) All interexchange carriers and other customers directly connecting with service provided by an exchange carrier shall make nondiscriminatory payments to such account based upon the annual ratio of the sum of payments made by each such carrier or other customer for such interconnection under section 233(c)(1) and section 233(c)(2) to the total of the sum of such payments by all such directly connecting interexchange carriers and other customers. All interexchange customers indirectly connecting to exchange service shall be assessed nondiscriminatory payments to such account in equivalent amounts for equivalent usage of such service.

"(3) Exchange carriers which, together with any affiliated exchange carriers, include not more than 50,000 main stations and equivalent stations, and which certify to the transitional joint board that their costs for the distribution of interexchange service and exchange service per main station or equivalent station, in the aggregate for any such carrier and its affiliates, exceed 110 percent of the national average of such costs shall be eligible for payments from the account established under paragraph (1) and shall be entitled to receive payments equal to that portion of their costs which exceeds 110 percent of such national average. The transitional joint board may designate by rule other exchange carriers—

"(A) which, together with any affiliates, include not more than 100,000 main stations and equivalent stations; and

"(B) which have high costs for the distribution of exchange service;

for payments from such account, subject to such modifications and conditions as the transitional joint board considers appropriate.

"(c) The National Telecommunications Fund also shall include an account to minimize disparities in charges for service by exchange carriers which, together with any affiliated exchange carriers, include not more than 50,000 main stations and equivalent stations which arise due to greater costs of providing connecting links for such service to and from rural or other remote areas. The transitional joint board shall establish the total amount necessary annually for such account, and shall order payments to eligible carriers for such costs which exceed 110 percent of the national average cost for such connecting links.

"(d)(1) The National Telecommunications Fund also shall include an account consisting of the total amount needed annually by exchange carriers (as determined by the transitional joint board), in excess of revenues from exchange access fees (including any revenues received in accordance with a division of revenues with other carriers) and any payments from the account established under subsection (b)(1) or subsection (c) to be collected by an exchange carrier, to provide for an orderly transition from the level of payment pursuant to jurisdictional separation and settlements procedures established under section 410(c) and in effect on January 1, 1982, to the level of payment, based only upon costs, available to exchange carriers under the system of exchange access fees established in section 233(c), for the purpose of avoiding substantial or undue increases in charges for exchange service which are beyond the control of an exchange carrier and which are caused by such transition.

"(2) The transitional joint board shall impose surcharges upon all interexchange transmissions sufficient to recover the total amount necessary annually for the account established in paragraph (1) and shall derive revenues for such account in the manner specified in subsection (b)(2).

"(e)(1) The National Telecommunications Fund shall be administered in a manner which expedites the disbursement of funds from the National Telecommunications Fund to eligible exchange carriers through the use of rules and procedures which eliminate burdens or delays in the certification or application process to the maximum extent practicable, and which permit disbursement decisions to be made on the basis of uniform, general, simplified standards of eligibility which are readily applied to the information and other data included in each application.

"(2) Payments from the National Telecommunications Fund to individual exchange carriers ordered by the transitional joint board shall be subject to audit and adjustment by the transitional joint board to ensure that—

"(A) any certification or application is valid and based upon proper allocation of costs in accordance with guidelines established by the transitional joint board or the Commission, as the case may be;

"(B) such payments are used to maintain reasonable rates and otherwise to carry out the purposes for which they were intended;

"(C) such payments do not remove incentives for the efficient provision of exchange service, except that any adjustment based upon the factor established in this subparagraph shall be effective only on a prospective basis; and

"(D) such payments do not unreasonably impede the entry and operation of competitive suppliers of exchange services.

"(f) For purposes of this section, any carrier which provides both interexchange and exchange services shall be considered to be an interexchange carrier to the extent such carrier provides interexchange services, and shall be considered to be an exchange carrier to the extent such carrier provides exchange services.

"COOPERATION WITH STATE COMMISSIONS

"SEC. 235. Not later than 180 days after the effective date of this section, the Commission shall establish a Federal-State Joint Board in accordance with section 410(c) to promote and facilitate the sharing of information among State commissions, and between State commissions and the Commission, regarding the rate structures, accounts, charges, practices, classifications, and regulation of carriers subject to the jurisdiction of the Commission or any State commissions.

"PART D—TELECOMMUNICATIONS EQUIPMENT

"TECHNICAL STANDARDS

"SEC. 241. (a) The Commission shall establish and enforce such uniform technical standards for terminal equipment and telecommunications facilities and services as are necessary—

"(1) to foster competition in telecommunications facilities, terminal equipment, information publishing, and enhanced services;

"(2) to ensure reasonable access to telecommunications by all residents of the United States (including persons with impaired hearing);

"(3) to prevent damage to the facilities or services of carriers; and

"(4) to support the national defense and emergency preparedness.

"(b) The Commission shall require that terminal equipment be labelled to identify the nation of origin and to disclose such other information as the Commission determines will be of significant interest to consumers.

"TERMINAL EQUIPMENT; INSIDE WIRING

"SEC. 242. (a) Except as provided in sections 214, 241, and 267, the Commission shall not impose any requirement upon, or exercise any control over, any person (other than a regulated carrier, a regulated exchange carrier, or an affiliate or separate subsidiary of such a carrier) which is engaged in the manufacture, sale, or supply of any telecommunications facilities, terminal equipment, or inside wiring.

"(b) Except as provided in this title, neither the Commission nor any State may regulate the production, installation, or marketing of terminal equipment by a regulated carrier or a regulated exchange carrier unless such carrier violates the requirements of subsection (e).

"(c) Not later than 180 days after the effective date of this section, the Commission shall prescribe rules which (1) provide for the separate pricing of terminal equipment offered by a regulated carrier or regulated exchange carrier after the effective date of such rules; and (2) require that such terminal equipment shall not be offered under tariffs, or included in the rate base of any such carrier, after the 2-year period following the effective date of this section.

"(d) Following the 2-year period after the effective date of this section, a dominant carrier or affiliate may provide terminal equipment only through a separate subsidiary or subject to section 272(f).

"(e) It shall be unlawful for any regulated carrier or any regulated exchange carrier to file any tariff for any regulated service which includes any cost associated with or caused by the provision of terminal equipment or inside wiring, except to the extent that (1) such equipment or wiring is provided under a tariff filed before the effective date of rules prescribed by the Commission under subsection (c); or (2) is authorized in section 272(f).

"(f) All persons offering—

"(1) terminal equipment;

"(2) inside wiring; or

"(3) telecommunications services and facilities;

shall provide separate charges, which shall be the same for items in each category whether offered in combination or separately.

"(g) The Commission may establish and enforce rules to ensure compliance with this section.

"TELECOMMUNICATIONS FACILITIES

"SEC. 243. (a) It is the purpose of this title to promote the development in the United States of a competitive industry for the manufacture of telecommunications facilities in order (1) to benefit users of regulated services by assuring the purchase by regulated carriers of facilities of the highest possible quality at the lowest possible cost; and (2) to promote the technological and commercial leadership of the United States in domestic and international telecommunications markets.

"(b)(1) The policies of regulated carriers relating to the procurement and construction of facilities shall promote the competition described in subsection (a) and avoid the imposition of unnecessary costs upon the users of regulated services. Regulated carriers shall not make any direct or indirect payments to any affiliated manufacturer of a telecommunications facility to offset the costs of the research, development, production, or marketing of such facility, except as contained in a contract for the purchase or lease of such facility filed with the Commission as required by section 223(d) or 252(d)(3).

"(2) Regulated carriers and regulated exchange carriers which are affiliated with such manufacturers of facilities shall procure on a nondiscriminatory basis any facility intended to be used to provide any regulated service or regulated exchange service. Such dealings between any regulated carrier or regulated exchange carrier and any affiliate which develops, manufactures, markets, evaluates, or controls the procurement of telecommunications facilities shall not be based upon, or include, any preference or discrimination arising out of such affiliation.

"(c)(1) Not later than the 3rd calendar year which begins after the effective date of this section, a dominant carrier shall purchase not less than 8 percent of its requirements in each product category from unaffiliated manufacturers. During each succeeding calendar year, a dominant carrier shall be required to procure the percentage required to be procured or actually procured in each product category from unaffiliated manufacturers during the preceding calendar year, whichever is greater, increased by a factor of 1.2 unless such carrier is procuring 30 percent of its requirements in such product category from unaffiliated manufacturers. Such requirements shall not apply to the extent that products manufactured in the United States which meet the reasonable specifications of the dominant carrier are not available in a timely manner at competitive prices from unaffiliated producers.

"(2) In the 10th calendar year after the effective date of this section, the Commission shall initiate a review of the effectiveness of this subsection in meeting the objectives of subsections (a) and (b). Based upon such review, the Commission shall, beginning in the 12th calendar year which begins after the effective date of this section, modify or eliminate the requirements of paragraph (1) for any or all product categories if the dominant carrier has established and maintains a policy of competitive procurement, and shall prescribe any rules necessary to continue such policy.

"(d) In order to protect users of regulated services from paying the costs of procurement by a dominant carrier on noncompetitive terms, the Commission may prescribe rules for the sale of equipment to unaffiliated persons to provide a market test for the charges and other terms under which such carrier purchases facilities from affiliates.

"(e) The Commission shall establish product categories for use in administering the provisions of subsections (c) and (d) on as narrow a basis as possible in order to achieve the purposes of this section.

"PART E—DOMINANT CARRIERS

"RELIEF FROM CONSENT DECREE APPLICABLE TO AMERICAN TELEPHONE AND TELEGRAPH COMPANY

"SEC. 251. (a) Notwithstanding the terms of the final judgment of January 24, 1956, of the United States District Court for the District of New Jersey involving the American Telephone and Telegraph Company and its affiliates (United States against Western Electric, et alia, No. 17-49), the Company hereby is authorized to provide any type of telecommunications facility, terminal equipment, or enhanced service. Such Company may offer any service, facility, or product (other than a transmission service or facility) only through a separate subsidiary meeting the requirements of section 252 or 253.

"(b) The provisions of this section shall not be construed to affect the application of section 302 of the Telecommunications Act of 1981.

"LIMITED SEPARATE SUBSIDIARY

"SEC. 252. (a) A subsidiary of a dominant carrier shall be designated a limited separate subsidiary if it meets the requirements of this section. Any limited separate subsidiary may perform the functions specified in only one of the following paragraphs—

"(1) the manufacture and marketing of terminal equipment, including equipment for the processing of data, and the manufacture and installation of inside wiring;

"(2) the provision of enhanced services; or

"(3) the provision of information publishing services.

"(b) Any separate subsidiary shall have a board of directors consisting of not less than 5 members, not more than 50 percent of whom are employees, officers, or directors of the dominant carrier or a separate subsidiary.

"(c) Any separate subsidiary shall maintain books, records, and accounts in a manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the dominant carrier, and which identify any conduct of business with the dominant carrier.

"(d) Any conduct of business between any separate subsidiary and the dominant carrier—

"(1) shall not be based upon any preference or discrimination arising out of affiliation;

"(2) shall be carried out in the same manner as the dominant carrier or the separate subsidiary is conducting such business with unaffiliated persons;

"(3) shall be pursuant to contract reported to the Commission in advance and made available for public inspection;

"(4) shall be fully auditable and reflect all costs associated with the conduct of such business; and

"(5) shall not have the effect of assigning or allocating the costs of any research, development, manufacturing, marketing, management, or any other factor associated with any offering of the limited separate subsidiary to services, facilities, or equipment which remain subject to regulation.

"(e) No separate subsidiary may provide information publishing service (as defined in section 263(h)(2)) which uses any facility owned by the dominant carrier.

"(f)(1) For purposes of demonstrating compliance with the provisions of this part, the records, books, and accounts of any separate subsidiary shall be audited annually in accordance with generally accepted auditing standards by independent certified public accountants.

"(2) The separate subsidiary shall make available all personnel, property, and records necessary to facilitate the audit, and shall bear all the costs associated with the audit.

"(3) The audits may not be conducted by any person which performs any services for the dominant carrier.

"(4) The separate subsidiary shall submit to the Commission the audit (certified by the person conducting the audit and by an appropriate officer of such subsidiary) not later than 5 months after the end of the fiscal year for which the audit is conducted. The Commission shall make the audit available for public inspection.

"(g) Any separate subsidiary may not (1) enter into any joint venture or partnership with the dominant carrier; (2) have a financial structure in common with the dominant carrier; or (3) own or use any property in common with the dominant carrier, except for the use of any transmission service provided by the dominant carrier under a tariff available to any unaffiliated person.

"(h) Any separate subsidiary shall carry out directly its own marketing, sales, advertising, installation of equipment, hiring and training of personnel, maintenance, operations, manufacturing, development, and research relating to services, facilities, and products offered by such separate subsidiary. Each separate subsidiary shall maintain a separate legal and accounting staff.

"(i)(1) Any separate subsidiary may use any trade name or other means of identifying its relationship with the dominant carrier, except that the value of goodwill associated with such trade name or means of identification shall be transferred in accordance with section 273(f).

"(2) The separate subsidiary may carry out institutional advertising with the dominant carrier, except that (A) such advertising may not be specifically related to any service or product; and (B) the separate subsidiary and the dominant carrier shall share the direct costs of such advertising equally.

"(j)(1) A separate subsidiary shall not issue any security unless such issue has been approved by the Commission. The Commission shall ensure that the separate subsidiary does not secure more capital than is necessary (A) to finance the purchase of any asset required to be transferred to the separate subsidiary by the dominant carrier; (B) to obtain an amount of working capital similar to that maintained by comparable corporations; and (C) to acquire any asset necessary to the operations of the separate subsidiary at the time of the capitalization.

"(2) The Commission shall not authorize any security which has the effect of allowing recourse or assessment against any asset of the dominant carrier or of increasing the cost of capital attributable to regulated activities of the dominant carrier.

"(3) The dominant carrier may not obtain any security issued by the separate subsidiary except upon payment in cash or equivalent of the market price of the security.

"(k) The amount of any class of outstanding capital stock of a limited separate subsidiary which may be owned by the dominant carrier shall not exceed three times the amount of such stock which is owned by unaffiliated persons. The amount of any issuance of a security by the limited separate subsidiary (other than capital stock) which may be purchased or owned by the dominant carrier shall not exceed three times the amount of such issuance which has been sold to unaffiliated persons in public offerings.

"(l) No limited separate subsidiary may own any transmission facilities or may provide any service, including any enhanced service, which is substantially similar to any transmission service offered by the dominant carrier.

"(m) In addition to any other authority which the Commission may exercise under this Act, the Commission may take such actions as are necessary to—

"(1) prevent anticompetitive practices between a general or limited separate subsidiary and the dominant carrier; and

"(2) protect users of regulated services and regulated exchange services from bearing any cost associated with the activities of a general or limited separate subsidiary.

"(n) Nothing in this section shall be construed to prohibit, and the Commission shall not have any authority to prohibit, any separate subsidiary and the dominant carrier from offering any program or plan on a joint basis to provide pension or other retirement benefits to their employees.

"(o) For purposes of this section, section 253, and section 254, the term 'the dominant carrier' means the person which owns the separate subsidiary, any affiliate, and any other separate subsidiary.

"GENERAL SEPARATE SUBSIDIARY

"SEC. 253. (a) A subsidiary of a dominant carrier shall be designated a general separate subsidiary if it meets the requirements of this section and the requirements established in subsection (b) through subsection (j) of section 252. A general separate subsidiary may perform any or all of the functions specified in section 252(a) and perform the additional functions authorized in this section.

"(b) The Commission shall authorize a general separate subsidiary to engage in the resale of a transmission service of a specified quality, economic cost, and geographic range if it determines that a sufficient number of unaffiliated deregulated carriers (including resellers) offer a sufficient quantity of such service to ensure that the entry of the general separate subsidiary will not affect substantially the pricing of such service.

"(c) The general separate subsidiary may not purchase, or receive by transfer, any transmission facility from a carrier affiliated with the dominant carrier and may not sell, lease, or otherwise make available any transmission facility to the dominant carrier.

"(d) After the 5-year period following the end of the period specified in section 274(d)(4), such general separate subsidiary may manufacture and sell transmission facilities if the dominant carrier has substantially complied with the provisions of section 243.

"(e)(1) The authority of the Commission to approve any security issued by a general separate subsidiary under section 252(j)(1) shall terminate at the end of the transition period specified in section 274(d)(4). Upon the termination of such transition period, a general separate subsidiary may construct, own, and operate transmission facilities.

"(2) During such period, the amount of any class of outstanding capital stock of the general separate subsidiary which may be owned by the dominant carrier shall not exceed four times the amount of such stock which is owned by unaffiliated persons. The amount of any issuance of a security by the general separate subsidiary (other than capital stock) which may be purchased or owned by the dominant carrier shall not exceed four times the amount of such issuance which has been sold to unaffiliated persons in public offerings.

"(f) The dominant carrier may not purchase or own any security of a general separate subsidiary other than any interest it lawfully acquired under subsection (e) and section 252(j) before the end of the period specified in section 274(d)(4).

"(g) Not more than one director of a general separate subsidiary may also be a director, officer, or employee of the dominant carrier.

"(h)(1) Neither the dominant carrier nor any individual employed by the dominant carrier may disclose any information to a general separate subsidiary which would confer a competitive advantage, unless such information is contemporaneously reduced to writing and promptly filed with the Commission in accordance with section 254.

"(2) A general separate subsidiary shall not engage in any joint activity with the dominant carrier, including the research, development, manufacturing, planning, design, marketing, or pricing of any service or facility.

"(3) This subsection shall not apply to members of the board of directors of the person which owns a general separate subsidiary to the extent that it would interfere with the discharge of their fiduciary obligation to manage and to direct the operations of the dominant carrier and the general separate subsidiary.

"(i) A general separate subsidiary and the dominant carrier shall be economically independent and separate persons for purposes of the Federal antitrust laws. Any common ownership, affiliation, or other relationship between such entities shall not constitute a defense in any action brought against any person authorized by such laws.

"INFORMATION REGARDING TRANSMISSION SERVICES AND FACILITIES OF DOMINANT CARRIER

"SEC. 254. (a) In accordance with procedures established by the Commission, a dominant carrier shall maintain and file with the Commission a description of protocols and technical requirements for connection with or use of its transmission services and facilities and shall report regularly to the Commission—

"(1) any material change relating to such protocols or requirements which has been adopted or implemented, or for which a decision has been made to adopt or implement, including any information or technical requirements relating to the capacity of services, facilities, or products to function effectively and efficiently if interconnected with any transmission service or facility furnished by the dominant carrier;

"(2) any material change in any protocol or technical interface requirement not already disclosed under paragraph (1) which will be required by the specific design or development of any telecommunications service, facility, or product;

"(3) summaries and relevant portions of construction programs or activities intended to maintain, extend, or expand the regulated services or facilities of the dominant carrier;

"(4) similar information relating to any regulated telecommunications network the disclosure of which the Commission determines to be necessary on its own initiative or in response to a petition submitted by any interested person;

"(5) other information regarding any regulated facility in the network of a dominant carrier which affects the capacity of services, facilities, or products to function effectively and efficiently if interconnected with such network; and

"(6) any results of research (including descriptions of projects, drafts, work in progress, or preliminary results) the costs of which are considered in determining the charge of any regulated service or any service offered by a regulated exchange carrier and which the dominant carrier discloses to any separate subsidiary.

"(b) No subsidiary, division, or affiliate of a dominant carrier may disclose to any other subsidiary, division, affiliate, or separate subsidiary of such dominant carrier any information required to be submitted under subsection (a) until such information has been made available to the public in accordance with subsection (c).

"(c) The dominant carrier shall promptly provide any person information required to be submitted under subsection (a) upon payment of copying fees authorized by the Commission, unless the Commission, after consultation with the Secretary of State, the Secretary of Defense, and any other Federal officer designated by the President, determines that the public availability of such information would be detrimental to the national defense or emergency preparedness.

"(d) The Commission shall establish additional standards to prohibit the disclosure by a dominant carrier of any information to any separate subsidiary which would confer a significant competitive advantage. The Commission shall prohibit the dominant carrier from providing any separate subsidiary with any commercial information, unless such information is made available to the competitors of such separate subsidiary at the same time and subject to the same terms and conditions.

"PART F—TELECOMMUNICATIONS INDUSTRY

"NETWORK PLANNING AND MANAGEMENT

"SEC. 261. It shall be lawful for carriers jointly to meet, plan, and agree, under the auspices of the Commission, on matters affecting the design, maintenance, management, development, and coordination of any network of telecommunications services or facilities (including the establishment of through routes), or the development of proposed technical standards applicable to such services and facilities. Nothing in this section shall be construed to authorize any meeting or other conduct among carriers the purpose or effect of which is to engage in any activity which is prohibited by Federal or State antitrust laws, or otherwise to limit or affect the application of Federal or State antitrust laws.

"NATIONAL SECURITY AND EMERGENCY PREPAREDNESS

"SEC. 262. (a) The Commission, in consultation with appropriate Federal agencies, may coordinate the development and establishment of arrangements among all interexchange carriers and international carriers for such mutual backup, restoration, and interconnection of the services of such carriers as may be necessary to avert public peril or disaster or to ensure the continuity of telecomunications essential to the national defense and the prompt restoration of any such telecommunications which may be interrupted by the failure or disruption of the facilities of any of such carriers.

"(b) The President may require any carrier or other person owning transmission facilities to furnish telecommunications services or facilities to any Federal agency if the President determines that—

"(1) the provision of such services or facilities is necessary and appropriate to support the national defense or the emergency preparedness of the United States; and

"(2)(A) the United States is at war, there is a threat of war, or there exists a state of public peril or disaster or other national emergency; or

"(B) in order to provide for the national defense or the emergency preparedness of the United States, there is an immediate need for such services and facilities, and such need cannot be met through reliance upon any other source of supply.

"(c) During any time of public peril, disaster, or other national emergency, as declared by the President, any Federal agency may authorize any carrier to cooperate with any other entity and to provide telecommunications products or services on a joint basis. The Commission may not impose any special auditing requirements that would interfere with the joint provision of such products and services during such time of public peril, disaster, or other national emergency.

"(d)(1) No transaction, cooperation, or joint activity associated with the provision of products and services authorized or required under subsection (b) or (c) shall cause the persons involved to become affiliates for the purposes of this title.

"(2) No joint activity between the dominant carrier and any separate subsidiary required under subsection (b) or (c) of this section shall constitute a violation of section 252 or 253.

"(3) The Commission may review and reallocate any division of revenues resulting from such joint activity between the dominant carrier and the separate subsidiary or between the regulated and unregulated activities of a regulated carrier or regulated exchange carrier in order to assure that (A) no cost of such joint activity is borne by the users of regulated services or exchange services; and (B) the compensation provided by subsection (e) is fairly allocated between regulated and unregulated activities.

"(e) In the event that the Federal agency and each person providing products and facilities under subsection (b) or (c) do not agree upon a level of compensation, the provisions of section 606(e) shall apply.

"(f) The President shall coordinate a Federal program to enhance the survivability of telecommunications facilities and to protect against unauthorized interception of telecommunications traffic, ensuring, where appropriate, that willing and able telecommunications carriers may participate.

"(g) The Chairman of the Commission shall designate a member of the Commission to serve as a national security-emergency preparedness Commissioner. Such member shall serve as the representative of the Commission to the President regarding national defense and emergency preparedness matters.

"(h) The President shall appoint an advisory council of not to exceed 15 members to (1) examine the structure, policy, and needs of Federal telecommunications management for national defense and emergency preparedness under deregulation; and (2) ensure that the United States shall have a technologically advanced and economically viable telecommunications industry for the purposes of national defense and economic advancement.

"DIVERSITY OF INFORMATION SOURCES

"SEC. 263. (a) It is the purpose of this section (1) to promote the widest possible diversity of information sources to the citizens of the United States; and (2) to assure that the provision of information publishing service by a carrier shall not reduce competition in the market for any information publishing service.

"(b)(1) Except as otherwise provided in this section, any carrier may offer an information publishing service over any facility it owns, except that no regulated carrier or regulated exchange carrier may file any tariff which is based upon costs associated with or caused by the provision of information publishing services, except the provision of directory listings or assistance, consisting only of name, telephone number, and address of telephone subscribers.

"(2) Regulated carriers and regulated exchange carriers shall not discriminate between affiliated persons (including any separate subsidiary) and unaffiliated persons or among unaffiliated persons in the provision of any transmission facility or service, or any other supporting function used in connection with information publishing services.

"(3) The rates and terms of any information publishing service which is offered by a regulated exchange carrier shall not take into account any revenue received by such carrier as a result of its provision of exchange service associated with such information publishing service.

"(c) In any case in which a regulated exchange carrier which owns more than 2,000,000 main stations and equivalent stations, provides any services or facilities used in connection with the provision of an information publishing service, such carrier or separate subsidiary shall make available the services and facilities used on nondiscriminatory terms, conditions, and charges to any person which makes a reasonable request for such services or facilities.

"(d) Notwithstanding any other provision of this Act, and except as otherwise provided in this section, no dominant carrier or separate subsidiary of such carrier may provide any information publishing service through any transmission facility which is used by such dominant carrier to provide regulated service or regulated exchange service.

"(e) Nothing in this section shall be construed to prohibit a dominant carrier from—

"(1) leasing or otherwise providing facilities, to any unaffiliated person, for the provision of information publishing services;

"(2) providing directory listings or assistance, consisting only of name, telephone number, and address of telephone subscribers; or

"(3) providing through a separate subsidiary (A) weather or time information; (B) printed directory advertising; (C) electronic directory information; or (D) any audio information service of the specific type, and in the same exchange area, that any such dominant carrier was providing as of December 1, 1981, during the 5-year period following the effective date of this section.

"(f) Any separate subsidiary which offers services described in subsection (e)(3) shall not offer any other products, services, or facilities.

"(g) The Commission may implement standards to monitor and enforce compliance with this section.

"(h) For purposes of this section:

"(1) The terms 'carrier' and 'dominant carrier' include any arrangement to share profits, revenues, and losses, any joint venture, or any equity interest in which such carrier or dominant carrier (or any separate subsidiary or affiliate of any such carriers) participates.

"(2) The term 'information publishing service' means provision to any unaffiliated person of any information—

"(A) which the publisher has (or has caused to be) authored, originated, gathered, collected, produced, compiled, edited, categorized, or indexed; or

"(B) in which the publisher has a direct or indirect financial or proprietary interest.

"(3) The term 'electronic directory information' means telephone subscriber listings by general business and product categories. Such listings may include only name, address, telephone number, and lists of distributors and dealers under such categories. Such term shall not include information concerning specific products or services, prices for products or services, or advertising.

"OWNERSHIP OF TELECOMMUNICATIONS FACILITIES

"SEC. 264. (a) The Commission shall promote wide diversity among information sources available to the citizens of the United States, and shall foster competition in the provision of telecommunications services and facilities, by prescribing rules to limit the consolidation or merger of two or more unaffiliated persons which own telecommunications facilities, the properties of such persons, or any part of such properties, in order to avoid excessive local or national concentrations in the ownership of telecommunications facilities, or of telecommunications facilities in combination with other media interests.

"(b)(1) No regulated exchange carrier may engage in the provision of cable services or broadcasting services in the same area in which such carrier is offering exchange services, except that carriers serving rural areas with low population densities, as defined by the Commission, may provide cable services in such areas subject to such rules as the Commission shall prescribe. The Commission shall prescribe such rules not later than 180 days after the effective date of this section.

"(2) For purposes of this subsection, the term 'cable service' means the retransmission of any television or radio broadcasting signal, or program origination, for distribution by cable or any other closed transmission medium to multiple subscribers who pay to receive such service.

"(c) [Reserved.]

"(d)(1) The Commission may allocate a portion of the electromagnetic spectrum for the provision of one or more transmission services. In specifying transmission services for which any such allocation is made, the Commission shall include any offerings which are similar in physical characteristics and in the range of users to which such offerings will be available.

"(2) Applicants for any such allocation shall be considered without any preference based upon the provision of any other service by any such applicant. The Commission may establish a preference which increases the diversity of persons authorized to use the electromagnetic spectrum, or any portion of the spectrum, if it determines that such preference will promote the purposes of this Act.

"(3) Any rule, regulation, or order prescribed or issued by the Commission after April 1, 1981, which is inconsistent with this subsection shall be null and void.

"INTERNATIONAL TRANSMISSIONS

"SEC. 265. [Reserved.]

"COMPETITION AMONG RECORD CARRIERS

"SEC. 266. [Reserved.]

"EQUITY IN INTERNATIONAL TRADE

"SEC. 267. (a) For the purpose of ensuring fair and equitable treatment of United States persons seeking access to foreign markets, the Commission shall establish policies, rules, regulations, and requirements prescribing terms and conditions for foreign enterprises supplying telecommunications services or facilities in the United States markets which are reciprocal with the terms and conditions under which United States persons are permitted to operate in—

"(1) the foreign nation in which the operations of such foreign enterprise offering telecommunications services or facilities is based; and

"(2) the foreign nation under the laws of which international transmissions or enhanced services offered by such foreign enterprise originate, terminate, or are regulated.

No other provision of this Act shall be construed to limit or otherwise to restrict the authority of the Commission established in this section, nor shall the provisions of this section be construed to limit or otherwise to restrict the authority of the Commission under any other provision of this Act.

"(b) Not later than 120 days after the effective date of this section, the Office of the United States Trade Representative shall compile a list of foreign nations which, by law or administrative practice, do not provide reciprocal rights to United States telecommunications equipment manufacturers. The Secretary of Commerce shall, upon petition by any person, revise such list upon the presentation of reasonable evidence to reflect changes in the law or practices relative to the access of United States persons to foreign markets.

"(c) Notwithstanding any existing or prospective agreement regarding the procurement of telecommunications facilities with a foreign nation, such foreign nation shall not be deemed to provide reciprocity in access to markets, operations, and rights of ownership unless it (1) is in compliance with such agreement; (2) provides full access to United States manufacturers under terms and conditions which do not distort research and development, investment, sales, or marketing; and (3) does not encourage or condone practices by its domestic manufacturers or government officials, the effect of which would be to inhibit the sales of United States telecommunications facilities in such foreign nation.

"(d) The Commission may exclude from any rights of interconnection established in this Act terminal equipment of which more than one-half of the value added was manufactured in any foreign nations which, according to the list established in subsection (b), do not extend reciprocal rights to United States manufacturers of terminal equipment. Such denial of certification may not include terminal equipment from foreign nations which are in the process of extending reciprocal access to United States telecommunications equipment manufacturers or which are engaged in substantive negotiations to extend such reciprocity.

"(e) In determining to restrict or preclude the entry of a foreign enterprise on the basis of lack of reciprocity, the Commission shall consult with the Secretary of Commerce, the Office of the United States Trade Representative, the Secretary of State, and any other Federal officer designated by the President.

"(f) For purposes of this section and section 243(c), a telecommunications facility shall be deemed to be manufactured in the United States if not less than 50 percent of its value is added into United States.

"(g) The Secretary of Commerce may (1) in consultation and coordination with the Commission and the United States Trade Representative, monitor the implementation of this section; and (2) collect such information as may be necessary to implement this section.

"(h) The Commission shall adopt rules, regulations, policies, requirements, and procedures, and may impose such restrictions upon foreign enterprises supplying telecommunications services or facilities necessary to carry out the purposes and provisions of this section and to carry out its determinations under this section, except that such rules shall not apply to services and facilities offered on the effective date of this section.

"PART G—PROTECTION OF RATEPAYERS AND EMPLOYEES IN TRANSITION TO COMPETITIVE MARKETPLACE

"DECLARATION OF PURPOSES

"SEC. 271. The purposes of this part shall be—

"(1) to ensure a transition to a competitive marketplace for telecommunications in a manner which is fair to ratepayers and protects them against unnecessary or undue financial burdens;

"(2) to encourage the continued growth of providers of telecommunications carriers;

"(3) to safeguard the employment rights of the employees of any regulated carrier or affiliate during such transition; and

"(4) to ensure that carriers are treated in a fair and equitable manner during such transition.

"TREATMENT OF TERMINAL EQUIPMENT AND INSIDE WIRING DURING TRANSITION

"SEC. 272. (a)(1) Any terminal equipment which is being provided by any regulated carrier to any customer under tariff on the effective date of this section, or before the end of the 2-year period following such effective date, shall continue to be made available to such customer under tariffs in force as of such dates, until such equipment is fully depreciated in accordance with schedules in effect on the effective date of this section, except that—

"(A) State commissions may increase such tariffs to reflect any reasonable increases in the costs of maintaining such equipment; and

"(B) such customer may purchase such equipment from such carrier at any time before such equipment is fully depreciated, for a price fixed by the State commission involved after considering the fair market value of such equipment.

"(2) Whenever any State commission determines that any such equipment has been fully depreciated, the customer using such equipment shall receive full ownership of such equipment, unless such State commission elects to allow a regulated carrier to retain ownership of such equipment or to provide for the sale or transfer of such equipment under subsection (c)(1)(A).

"(b) Each State commission shall proceed to require tariffs for the sale of terminal equipment on an unbundled basis not later than 180 days after the effective date of this section. Each carrier shall submit tariffs for such sale as promptly as possible.

"(c)(1) Each State commission shall authorize the public sale of any terminal equipment which is owned by a regulated carrier and which is—

"(A) specified in subsection (a)(1), if the State commission makes the election specified in subsection (a)(2);

"(B) in inventory as of the end of the 2-year period following the effective date of this section, but (i) not in use as of the end of such period; and (ii) not needed by such carrier to maintain the terminal equipment specified in subsection (a)(1); or

"(C) withdrawn from use after the end of such 2-year period, in a manner consistent with the course of dealing in effect on the effective date of this section, as a result of (i) a change in residence by the customer involved; (ii) a voluntary return of such equipment by the customer; or (iii) any similar factor.

"(2) If a State commission authorizes a public sale under paragraph (1), such State commission shall require carriers to provide notice of such sale to prospective purchasers of the terminal equipment involved and to the general public.

"(3) In determining the timing and manner of any public sale and the units for which bids are accepted, a State commission shall promote the orderly development of a competitive secondary market and shall achieve the maximum compensation to the ratepayers of regulated exchange carriers. A separate subsidiary of a dominant carrier, and any unregulated activity of any other carrier, may submit bids in any such public sale.

"(d) The Commission shall establish such rules and procedures as may be necessary to ensure that a regulated carrier, or any manufacturing affiliate or separate subsidiary of such carrier, shall—

"(1) make available at reasonable charges, for not less than 6 years, a supply of parts sufficient to maintain terminal equipment specified in subparagraph (A), (B), or (C) of subsection (c)(1); and

"(2) upon reasonable request and for reasonable compensation, furnish the technical and production specifications for such parts to any person.

"(e) During the 2-year period following the effective date of this section, a State commission shall have jurisdiction and authority over terminal equipment offered for lease or sale in such State by any regulated carrier or its affiliates, except that, in the case of a dominant carrier, such jurisdiction and authority shall continue until the Commission approves the establishment of a separate subsidiary by a dominant carrier for purposes of leasing or selling terminal equipment.

"(f)(1) Regulated exchange carriers shall continue to offer inside wiring on a regulated basis during the 5-year period following the effective date of this section. After such period, the Commission, after consultation with State commissions, may require regulated carriers to continue such offerings if the Commission determines that such continued offerings serve the purposes of this title.

"(2) Any customer may purchase inside wiring from a regulated exchange carrier before such wiring is fully depreciated for a charge which is fixed by the State commission involved. After the effective date of this section, any person (other than a dominant carrier) may offer inside wiring on an unregulated basis.

"(g) The State commissions shall take into account the revenues obtained from the transfer or sale by a regulated carrier or a regulated exchange carrier of any terminal equipment or inside wiring in any proceeding to determine the lawfulness of any tariff submitted by such carrier.

"TRANSITIONAL JOINT BOARD

"SEC. 273. (a) Not later than 90 days after the effective date of this section, a transitional joint board shall be established by the Commission in accordance with this section for the purpose of—

"(1) evaluating the assets of regulated carriers and determining the value of assets transferred by regulated carriers to separate subsidiaries or for use in connection with unregulated activities;

"(2) ensuring equitable economic treatment of users of exchange service and interexchange service;

"(3) providing for an orderly transition to the system of exchange access fees established in section 233; and

"(4) achieving cooperation between the Federal Government and the States in carrying out the purposes of this title.

"(b) The authority of the transitional joint board with respect to the functions established in this section shall supersede the authority of any joint board established under section 410 and in existence on the effective date of this section.

"(c) The transitional joint board shall be composed of—

"(1) 3 commissioners of the Commission, designated by the Commission; and

"(2) 2 State commissioners nominated in accordance with section 410(c) and approved in accordance with section 410(a).

"(d) The transitional joint board shall appoint and fix the pay of such officers, engineers, accountants, attorneys, inspectors, examiners, and other personnel as may be necessary to assist the transitional joint board in carrying out its functions under this title. The staff of the transitional joint board shall be appointed subject to the provisions of title 5, United States Code, governing appointments in the competitive service, and shall be paid in accordance with the provisions of chapter 51 and subchapter III of chapter 53 of such title relating to classification and General Schedule pay rates.

"(e) The transitional joint board may perform such acts, establish such rules and regulations, and issue such orders as are consistent with the provisions of this Act and as may be necessary to carry out its functions under this title. The transitional joint board—

"(1) may make minor modifications with respect to rules applicable to the establishment of exchange area boundaries;

"(2) shall establish and maintain formulas for determining the amounts and means necessary to fund the accounts of the National Telecommunications Fund, and to order and oversee the distribution of funds from the National Telecommunications Fund in accordance with section 234;

"(3) shall make such changes and modifications in jurisdictional separation and settlements procedures (established under section 410(c) and in force on the effective date of this section) as may be necessary or appropriate for the orderly transition to the system of exchange access fees established in section 233 to compensate exchange carriers for the costs of distributing interexchange transmissions through the use of the facilities of such exchange carriers;

"(4) shall determine at regular intervals the relative assignment by exchange carriers of overall costs of exchange transmission facilities which are not directly caused by the volume of interexchange transmissions through the use of such facilities, to interexchange services, to assure that interexchange carriers and other customers pay amounts which reflect the cost of using the facilities of exchange carriers, except that the total level of payments from interexchange carriers to exchange carriers in accordance with access fees and the National Telecommunications Fund shall not exceed the level of payments which exists on January 1, 1982, exclusive of (A) any increases in direct costs; (B) any increases required in the National Telecommunications Fund accounts established in section 234(b)(1) and section 234(c)(1); or (C) payments reflecting (i) any increases in relative usage; or (ii) the portion of any increases in such overall costs which is attributable to relative usage;

"(5) shall furnish advice to the Commission with respect to determinations of the Commission regarding terms and conditions for equivalent access by interexchange carriers and other customers for interconnection with exchange telecommunications facilities, and regarding the manner of such interconnection; and

"(6) shall carry out the evaluation of assets of regulated carriers or regulated exchange carriers and the other functions established in subsection (f).

"(f)(1) The transitional joint board shall determine the value of any assets which are subject to the jurisdiction of any State commission before the effective date of this section and which are subsequently transferred to any separate subsidiary or to any entity carrying out unregulated activities.

"(2) Such value shall be—

"(A) the fair market value of the business or asset involved, including the value of the business as a going concern, as determined by the sale to unaffiliated persons of any comparable asset or of a business comparable in profitability;

"(B) the listed book value of such business or asset on the closing date of any transfer, if such value is greater than the value derived under subparagraph (A); or

"(C) an equitable valuation of such business or asset if the transitional joint board is unable to ascertain the value of such business or asset under subparagraph (A) or (B).

"(3) Valuations of the transitional joint board under this subsection shall be binding upon the Commission and upon State commissions unless the Commission determines any such valuation to be arbitrary or capricious or otherwise not consistent with the purposes of this Act.

"(4)(A) A separate subsidiary shall reimburse regulated carriers and regulated exchange carriers affiliated with the person which owns such separate subsidiary for any asset or payment which was transferred from such carrier, and for all activities of such regulated carrier, including training, research, development, and advertising, which are associated with personnel or assets transferred to such separate subsidiary or which benefit such separate subsidiary, regardless of whether such activities or payments occur before or after the effective date of this section.

"(B) Any unregulated activity of a regulated carrier shall make reimbursements to the regulated accounts of such carrier in the manner required for separate subsidiaries in subparagraph (A).

"(C) Such separate subsidiary or unregulated activities shall make such reimbursement in cash or equivalent, and the carriers shall use such payments to offset their revenue requirements. The Commission shall allow the separate subsidiary a capitalization sufficient to finance any payments required by this paragraph.

"(5) The transitional joint board may delegate its authority under this subsection to State commissions in the case of any regulated exchange carriers which, together with any affiliates, include less than 500,000 main stations and equivalent stations.

"(g)(1) Any rulemaking or adjudication of the transitional joint board under this section shall be subject to chapter 5 of title 5, United States Code.

"(2) Any determination made by the transitional joint board under this section (other than any valuation under subsection (f)(3)) shall be considered a final action subject to judicial review under section 402(a), and subsections (c) through (j) of section 402.

"(h) Except as provided in subsection (c)(2), the provisions of section 410 shall not apply to the transitional joint board.

"(i) The transitional joint board shall terminate at the end of the 5-year period following the effective date of this section. Upon such termination, the powers and responsibilities of the transitional joint board shall be carried out by the Commission.

"TREATMENT OF CERTAIN INTEREXCHANGE SERVICE DURING TRANSITION

"SEC. 274. During the 5-year period following the effective date of this section, a State commission may continue to exercise the authority vested in the Commission in section 226 with respect to any regulated service which originates and terminates within the boundaries of the State.

"TREATMENT OF DOMINANT CARRIER DURING TRANSITION

"SEC. 275. (a)(1) Before a dominant carrier may offer any telecommunications service or equipment through a separate subsidiary, it shall file with the Commission a plan demonstrating its proposed method of compliance with the requirements of part E.

"(2) As soon as practicable after the filing of such plan, but in any event not later than one year after such filing, the Commission shall issue an order approving the plan or stating the specific parts of the plan which conflict with the purposes or provisions of this title or rules prescribed by the Commission under this title. The Commission, before issuing such order, shall publish notice of the receipt of such plan and shall provide an opportunity for the submission of public comments regarding such plan.

"(3) In the case of disapproval, the dominant carrier may submit an amended plan to the Commission.

"(4) After approval of any plan by the Commission, a dominant carrier shall submit to the Commission any revision of, or addition to, such plan, including any subsequent transfer of assets, for review by the Commission to ensure that such revision, addition, or transfer complies with the requirements of this title. Any significant revision of, or addition to, such plan, or any significant transfer of assets, shall be submitted to the Commission for approval before such revision, addition, or transfer is carried out. The requirements of this paragraph shall apply during and after the transition period.

"(b) In the initial plan submitted by a dominant carrier under subsection (a)(1) after the effective date of this section, the dominant carrier shall elect to comply with the requirements of part E through the establishment of either (1) one or more limited separate subsidiaries; or (2) one general separate subsidiary, which may include limited separate subsidiaries. Upon approval of such plan, the dominant carrier may not alter such election.

"(c)(1) The Commission shall determine the value of any assets which are not solely subject to the jurisdiction of any State commission before the effective date of this section and which are proposed to be transferred to any separate subsidiary or to any entity carrying out unregulated activities.

"(2) Such value shall be determined in accordance with section 273(f)(2).

"(3) The Commission shall allocate to regulated carriers and regulated exchange carriers any portion of a payment made under section 273(f)(4) which is associated with activities and assets not subject to the jurisdiction of any State commission. Such payment shall offset the revenue requirements of such carriers.

"(d)(1) Not later than 2 years after a dominant carrier obtains approval of a plan it submits under this section, the final assembly (including all aspects integral to final assembly) of any products which are required to be offered by a separate subsidiary, and the marketing, sales, and other operations relating to such products, shall be provided by a separate subsidiary or acquired from unaffiliated persons.

"(2) Not later than 2 years after a dominant carrier obtains such approval, all applied research for, and development of, any enhanced services, terminal equipment, or other products (including software) which are required to be offered by a separate subsidiary shall be provided by a separate subsidiary or acquired from unaffiliated persons.

"(3) Not later than 3 years after a dominant carrier obtains such approval, all subassemblies (including any research and development for such subassemblies) incorporated in any product which is required to be offered by a separate subsidiary shall be manufactured by a separate subsidiary or acquired from unaffiliated persons.

"(4) Not later than 4 years after a dominant carrier obtains such approval, all components (including any research and development for such components) incorporated in any product which is required to be offered by a separate subsidiary shall be manufactured by a separate subsidiary or acquired from unaffiliated persons.

"(5) Notwithstanding paragraphs (3) and (4), any subassembly or component which is used exclusively in the production of terminal equipment, or any research and development which relates exclusively to the production of terminal equipment shall be provided by a separate subsidiary or acquired from unaffiliated not later than 2 years after the approval of the plan.

"(e)(1) A separate subsidiary may provide terminal equipment during the 2-year period following the effective date of this section only if the final assembly of such terminal equipment is performed by a separate subsidiary or acquired from unaffiliated persons.

"(2) The separate subsidiary shall perform itself or acquire from unaffiliated persons any research or development (including software) commenced after approval of the plan which relates to services, facilities, and products which may only be offered through such separate subsidiary.

"(3) No affiliate of the dominant carrier may sell or lease to any separate subsidiary any facility constructed or acquired after approval of the plan which is used to develop, manufacture, or supply any service, facility, or product which may only be offered through such separate subsidiary, except as provided for in section 252(g)(3).

"(f) For purposes of this section, the terms 'subassembly' and 'component' shall not include any subassembly or component which is used exclusively in the production of terminal equipment, or any research and development which relates exclusively to the production of terminal equipment.

"(g) Not later than 180 days after the effective date of this section, the Commission shall prescribe such rules as may be necessary to carry out the provisions of this section.

"EMPLOYEE PROTECTION

"SEC. 276. (a) For purposes of this section:

"(1) The term 'employee' means any employee of a carrier, or of any affiliate, which establishes a separate subsidiary.

"(2) The term 'regular employee' means any full-time or part-time employee whose employment is expected to be permanent and who is not classified as a term, temporary, or occasional employee.

"(3) The term 'transferred employee' means (A) any regular employee transferred as a part of a work group or organization to a separate subsidiary by a carrier or by any affiliate and whose transfer is the result of the work and duties which the employee and work group performed in the employ of the carrier or affiliate being transferred to the separate subsidiary; or (B) any regular employee who accepts voluntary transfer to meet the employment needs of the separate subsidiary.

"(b)(1) If a carrier or any affiliate transfers a regular employee to a separate subsidiary, then such transferred employee shall not as the result of such transfer be deprived of employment rights, salary or wages, net credited service, or term of employment during the 5-year period following the date of such transfer, except as otherwise provided in this section. The requirements of this paragraph shall continue to apply in any case in which the separate subsidiary retransfers such transferred employee to the carrier or to any affiliate, except that any such retransfer shall not have the effect of extending the 5-year period specified in the preceding sentence.

"(2) Except as otherwise provided in this section, no term, temporary, or occasional employee shall, as a result of his transfer to a separate subsidiary, be deprived of employment rights or salary or wages arising from employment in the carrier or affiliate.

"(c)(1) A transferred employee shall be entitled to receive payment (in addition to his regular salary or wages) from the separate subsidiary to which such employee is transferred for reasonable travel expenses and reasonable moving expenses incurred by such employee or any of his dependents if—

"(A) such transferred employee changes his domicile as a result of such transfer; and

"(B) the distance between the new work location of such transferred employee and the former domicile of such transferred employee exceeds the distance between the former workplace of such transferred employee and such former domicile by 35 miles or more.

"(2) If a collective bargaining agreement applicable to a transferred employee provides transfer benefits which differ from the benefits available to such transferred employee under paragraph (1), then such transferred employee shall receive the greater of the transfer benefits under the applicable collective bargaining agreement or the benefits under paragraph (1), but not both.

"(d) During the 7-year period following the transfer of any employee, no pension benefits, health or disability benefits, death benefits, or insurance benefits to which such transferred employee is entitled shall be restricted, limited, or reduced as a result of the transfer to a separate subsidiary, except that the requirements of this paragraph may be superseded by the terms of any collective bargaining agreement between such separate subsidiary and any labor entity representing the employees of such separate subsidiary.

"(e) The provisions of any collective bargaining agreement between a carrier or any affiliate, and any labor entity representing the employees of such carrier or affiliate shall continue to apply to any transferred employee during the complete term of such agreement, unless and until the separate subsidiary, or any person which owns such separate subsidiary, and any labor entity representing the employees of such separate subsidiary enter into a collective bargaining agreement applicable to such employee.

"(f)(1) Except as provided in paragraph (2), a transferred employee, whose employment with the separate subsidiary is terminated during the 7-year period following the date of such transfer, shall be entitled to receive a termination allowance from such separate subsidiary in an amount which is not less than the amount of termination allowance, if any, such transferred employee would have been entitled to receive from such carrier or such affiliate if such carrier or such affiliate terminated the employment of such transferred employee.

"(2) If a collective bargaining agreement between a separate subsidiary and any labor entity representing the employees of such separate subsidiary applies to such transferred employee at the time his employment is terminated and provides benefits which differ from the benefits available to such transferred employee under paragraph (1), then such transferred employee shall receive the greater of the benefits under the applicable collective bargaining agreement or the benefits under paragraph (1), but not both.

"(g)(1) If any transferred employee is the subject of a layoff by the separate subsidiary during the 7-year period following the date of the initial transfer of such transferred employee to a fully separated affiliate, then such transferred employee shall have a preferential right of rehire by the separate subsidary, and by the carrier and its affiliates, in his occupational specialty (or its equivalent) during the 2-year period following the date of the layoff of such transferred employee, except that such right shall not apply unless such transferred employee is physically able, and equipped by training and experience, to perform the duties of the work available. Such preferential right of rehire shall be in order of term of employment from among those laid-off employees having a preferential right of rehire. Such separate subsidiary shall maintain lists of employees who have been separated from employment through layoffs, and shall provide copies of such lists to the carrier and its affiliates. Such lists shall contain sufficiently detailed information to enable such separate subsidiary to comply with the requirements of this subsection.

"(2) Nothing in this section shall be construed to prevent the separate subsidiary from offering and a transferred employee from accepting a downgrade to a lower rated job or other reduction in wages and related benefits as an alternative to a layoff by the separate subsidiary. Any employee accepting such a downgrade shall be entitled to the preferential right of rehire specified in paragraph (1).

"(h) A carrier or any affiliate which intends to transfer to a separate subsidiary a work group or organization or substantial part thereof in which employees represented by a labor organization are employed shall notify such labor organization at least 30 days before the effective date of such transfer. Such notice shall state the effective date of the transfer, the work group or organization involved, the number of employees affected, and the job classifications of such employees.

"(i) A carrier or any affiliate shall not reduce the salary or wages of a regular employee, or separate such regular employee from employment through layoff or termination, during the 6-month period immediately before the establishment of a separate subsidiary by such carrier or by such affiliate unless—

"(1) such regular employee consents to such action; or

"(2) such action is not related to the establishment of such separate subsidiary.

"(j) The provisions of this section shall not apply to any employee who is transferred to a separate subsidiary after the 7-year period following the date of the establishment of such separate subsidiary.

"(k) Nothing in this section shall be construed to eliminate the authority of a carrier, an affiliate, or a separate subsidiary to terminate the employment of an employee or transferred employee or take any disciplinary action against an employee or transferred employee for cause.

"(l)(1) An action to enforce any rights or liabilities created by this section may be brought in a United States district court regardless of the amount in controversy or in any other court of a competent jurisdiction. In the case of an action arising under this section which is brought in a district court of the United States, the action may be brought in the judicial district where one or more of the plaintiffs reside in addition to any other judicial district provided by law.

"(2) No action may be brought under this section later than 3 years after the right to that action arises.

"(3) Nothing in this section shall preclude any employee, employer, or labor organization from seeking any available remedy under an applicable collective bargaining agreement or existing applicable Federal, State, or local law.

"(4) Resolution of issues concerning employee representation and appropriateness or clarification of bargaining unit in a separate subsidiary established under this Act shall be in accordance with the rules and procedures established in the National Labor Relations Act. Nothing in this section shall be construed to modify or amend any provision of the National Labor Relations Act.

"PART H—RIGHTS OF RATEPAYERS

"RIGHTS OF USERS OF REGULATED SERVICES

"SEC. 281. It is the policy of this Act to ensure that users of regulated services—

"(1) have access to telecommunications facilities of the highest quality which offers universal and diverse service;

"(2) enjoy the benefits of competition, and are protected from monopoly power in markets which are not subject to competitive conditions;

"(3) avoid the costs imposed upon the national economy by unnecessary governmental regulation;

"(4) do not bear any cost associated with the participation of regulated carriers in competitive markets or with the provision of unregulated services or products by such carriers; and

"(5) have access to the widest possible variety of diverse information sources.

"PUBLIC PARTICIPATION

"SEC. 282. The Commission may provide financial assistance for the direct costs of participation, including reasonable fees for attorneys and expert witnesses, by any person in any proceeding under this title (including any proceeding of the transitional joint board in which there may be public participation) when—

"(1) the person applying for assistance represents an interest—

"(A) which would not otherwise be represented adequately in such proceeding; and

"(B) representation of which is necessary for a fair disposition of the proceeding; and

"(2) the person applying for such assistance does not have sufficient resources available to participate effectively in the absence of financial assistance.

"NONREGULATORY REMEDIES

"SEC. 283. (a) If any person—

"(1) violates section 222, 223(a), 223(b)(3), 228(b), or 243(b);

"(2) fails to provide an interconnection required by section 214(a), 214(b), 232(b)(1), or 232(c);

"(3) files a tariff which is unlawful under section 228(c), 233(c), 242(e), or 263(b)(1); or

"(4) fails to provide service required by section 223(a), 232(d), 242(f), 263(c), or 265;

any interested person may commence a civil action for injunctive relief restraining such violation, and a civil action for damages, in any district in which the defendant resides or has an agent. The filing of any such action shall not restrict any right which such interested person may have under any statute or common law In any action brought under this section, the court may award the costs of litigation (including reasonable fees for attorneys and expert witnesses).

"INDIVIDUAL PRIVACY

"SEC. 284. (a) The Commission shall prescribe rules to protect the privacy of (1) persons using regulated services; and (2) the employees of regulated carriers.

"(b) Rules prescribed by the Commission under subsection (a) shall limit the circumstances under which regulated carriers may (1) intercept conversations of transactions between their employees and users of regulated services; and (2) make available information derived from the provision of regulated services to any person, including any law enforcement agency, except as specifically required by this title or by any other provision of law.".

(c) Title II of the Communications Act of 1934, as amended in subsection (a), is further amended—

(1) in section 201 thereof, by striking out the heading, by striking out the section designation, by redesignating subsection (a) as section 265, and by transferring such section (as so redesignated) to immediately follow section 264, as added by the amendment made in subsection (b);

(2) in section 206 thereof, by inserting "(a)" after the section designation, by redesignating such section as section 511, and by transferring such section (as so redesignated) to immediately follow section 510 (as added by the amendment made in subsection (c));

(3) in section 217 thereof, by striking out the heading, by redesignating such section as subsection (b) of section 511, and by transferring such section (as so redesignated) to immediately follow subsection (a) of section 511 (as so redesignated in paragraph (2));

(4) in section 207 thereof, by striking out the heading, by redesignating such section as subsection (c) of section 511, and by transferring such section (as so redesignated) to immediately follow subsection (b) of section 511 (as so redesignated in paragraph (3));

(5) in section 208 thereof, by striking out the heading, by redesignating such section as subsection (d) of section 511, and by transferring such section (as so redesignated) to immediately follow subsection (c) of section 511 (as so redesignated in paragraph (4));

(6) in section 209 thereof, by striking out the heading, by redesignating such section as subsection (e) of section 511, and by transferring such section (as so redesignated) to immediately follow subsection (d) of section 511 (as so redesignated in paragraph (5));

(7) in section 210 thereof, by striking out the heading, by redesignating such section as section 229, and by transferring such section (as so redesignated) to immediately follow section 228, as added by the amendment made in subsection (b);

(8) in section 212 thereof, by striking out the heading, by redesignating such section as subsection (c) of section 265, and by transferring such section (as so redesignated) to immediately follow subsection (b) of section 265, as added by the amendment made in subsection (b);

(9) in section 213 thereof, by striking out the heading, by striking out the section designation, by striking out "section" each place it appears therein and inserting in lieu thereof "subsection", by striking out "paragraph (c)" and inserting in lieu thereof "paragraph (3)", by redesignating subsection (a) through subsection (h) as paragraph (1) through paragraph (8) of section 224(a), and by transferring such paragraphs (as so redesignated) to immediately follow the subsection designation for subsection (a) of section 224, as added by the amendment made in subsection (b);

(10) in section 214 thereof, by striking out the heading, by striking out the section designation, by redesignating paragraph (1) through paragraph (3) in subsection (a) thereof as subparagraph (A) through subparagraph (C), respectively, by redesignating subsection (a) through subsection (d) as paragraph (1) through paragraph (4) of subsection (a) of section 225, and by transferring such paragraphs (as so redesignated) to

immediately follow the section designation for section 225, as added by the amendment made in subsection (b);

(11) in section 215 thereof, by striking out the heading, by striking out the section designation, by redesignating paragraph (1) through paragraph (3) in subsection (a) thereof as subparagraph (A) through subparagraph (C), respectively, by redesignating subsection (a) through subsection (c) as paragraph (1) through paragraph (3) of subsection (b) of section 225, and by transferring such paragraphs (as so redesignated) to immediately follow subsection (a) of section 225, as added in paragraph (10);

(12) in section 220 thereof, by striking out the heading, and by transferring subsection (b) through subsection (j) to immediately follow subsection (a) of section 224, as added in paragraph (9);

(13) in section 222 thereof, by striking out the heading, by redesignating such section as section 266, and by transferring such section (as so redesignated) to immediately follow section 265, as added by the amendments made in paragraph (8) and subsection (b);

(14) by redesignating section 223 thereof as section 512, and by transferring such section (as so redesignated) to immediately follow section 511, as added

by the amendments made in paragraphs (2) through (6); and

(15) in section 224 thereof, by striking out the heading, by striking out the section designation, by striking out "section" each place it appears therein and inserting in lieu thereof "subsection", by striking out "subsection" the last place it appears therein and inserting in lieu thereof 'paragraph", by striking out "subsection (c)" and inserting in lieu thereof "paragraph (3)", by striking out "subsection (b)" and inserting in lieu thereof "paragraph (2)", by redesignating paragraph (1) through paragraph (4) in subsection (a) thereof as subparagraph (A) through subparagraph (D), respectively, by redesignating paragraph (1) and paragraph (2) in subsection (b) thereof as subparagraph (A) and subparagraph (B), respectively, by redesignating subparagraph (A) and subparagraph (B) in subsection (c)(2) thereof as clause (i) and clause (ii), respectively, by redesignating paragraph (1) and paragraph (2) in subsection (c) thereof as subparagraph (A) and subparagraph (B), respectively, by redesignating paragraph (1) and paragraph (2) in subsection (d) thereof as subparagraph (A) and subparagraph (B), respectively, by redesignating subsection (a) through subsection (d) as paragraph (1) through paragraph (4) of section 232(e),

and by transferring such paragraphs (as so redesignated) to immediately follow subsection (d) of section 232, as added by the amendment made in subsection (b).

REMEDIES FOR CERTAIN VIOLATIONS OF TITLE II

SEC. 202. Title V of the Communications Act of 1934 is amended by adding at the end thereof the following new section:

"REMEDIES FOR CERTAIN VIOLATIONS OF TITLE II

"SEC. 510. (a) Upon a finding of any violation of any provision of title II by a regulated carrier or any affiliate or separate subsidiary of a regulated carrier, the Commission shall have remedial authority to increase the requirements established with respect to regulated carriers (including the requirements relating to separate subsidiaries) in title II. The Commission may exercise such authority to increase such requirements if it finds that such exercise of authority is necessary to carry out the purposes of title II. In making such a finding, the Commission shall—

"(1) take into account the level of competition in the market or markets for telecommunications services, facilities, or equipment involved;

"(2) evaluate the degree to which the conduct of the carrier involved has an adverse impact upon the purposes of title II, and take into account whether, and to what extent, the carrier has engaged in (A) anticompetitive or discriminatory practices; or (B) practices which have an adverse impact upon users of regulated services or facilities provided by the carrier.

"(b) The Commission, in carrying out any increase in the requirements established in title II, shall ensure that the extent of such increase is an effective and appropriate response to the circumstances addressed by the Commission.".

TITLE III—MISCELLANEOUS PROVISIONS

DEFINITIONS

SEC. 301. Section 3 of the Communications Act of 1934 is redesignated as section 103 and is amended—

(1) by striking out paragraphs (a), (h), (r), (s), (t), and (u);

(2) by redesignating paragraph (b) through paragraph (g) as paragraph (1) through paragraph (6), respectively, by redesignating paragraph (i) through paragraph (q) as paragraph (7) through paragraph (15), respectively, and by redesignating paragraph (v) through paragraph (ff) as paragraph (16) through paragraph (26), respectively; and

(3) by adding at the end thereof the following new paragraphs:

"(27)(A) 'Affiliate', 'affiliated', and 'affiliation', whenever used with reference to any entity, mean any person (other than a separate subsidiary) which—

"(i) owns or controls such entity or is owned or controlled by such entity;

"(ii) is under direct or indirect common ownership with such entity; or

"(iii) enters into any partnership or joint venture with such entity.

"(B) 'Unaffiliated', whenever used with reference to any entity, means any person (other than a separate subsidiary of such entity) which is not affiliated with such entity or with any separate subsidiary of such entity.

"(28) 'Dominant carrier' means—

"(A) any carrier classified as a dominant carrier by the Commission under section 212;

"(B) any person which owns such carrier; or

"(C) any affiliate of such carrier or of such person, to the extent such affiliate provides transmission services.

"(29) 'Electronic transmission' and 'transmission' mean the delivery of information to a designated destination by means of electromagnetic impulses (including impulses of light) with a capacity for replies to such information. Such terms shall include any switching, error correction, regulated telecommunications network control, and routing used by a carrier to deliver such information to a designated destination. Such terms shall not include any function which alters the format, protocols, content, or destination of such information in the course of such transmission.

"(30) 'Electronic transmission facility', 'transmission facility', and 'facility' mean any transmission medium, switch, instrument, or other facility (other than terminal equipment) which is used, in whole or in part, to provide any transmission.

"(31)(A) 'Enhanced service' means the offering of a capacity—

"(i) to generate, acquire, store, transform, retrieve, forward, utilize, or otherwise process or make available information in a form capable of electronic transmission; or

"(ii) to alter the format, protocols, content, or destination of an electromagnetic impulse (including an impulse of light) during such transmission.

"(B) Such term shall not include—

"(i) any operation carried out by terminal equipment on the premises of a user who originates or receives a transmission;

"(ii) any use of any such capacity solely to control, manage, or operate a transmission system or service; or

"(iii) any information publishing service.

"(32) 'Exchange carrier' means any carrier which provides exchange transmission service. Any person engaged in the provision of cable service (as defined in section 264(b)(2)) shall not be considered to be an exchange carrier for purposes of title II, to the extent such person is so engaged in the provision of any such service, except that nothing in this paragraph shall be construed to affect any authority of any State or local government, as such authority exists on the effective date of the Telecommunications Act of 1981.

"(33) 'Exchange transmission' means the provision of transmission service by a carrier among points within a single exchange telecommunications area.

"(34) 'Exchange telecommunications area' and 'exchange area' mean any area designated by a State commission or by the transitional joint board in accordance with section 231.

"(35) 'Federal antitrust laws' includes—

"(A) the Sherman Act (15 U.S.C. 1 et seq.), section 73 through section 77 of the Wilson Tariff Act (15 U.S.C. 8-11), the Act entitled 'An Act to amend sections 73 and 76 of the Act of August 27, 1894, entitled "An Act to reduce taxation, to provide revenue for the Government, and for other purposes" ', approved February 12, 1913, the Clayton Act (15 U.S.C. 12 et seq.), the Federal Trade Commission Act

(15 U.S.C. 41 et seq.), and section 5 of the Webb-Pomerene Act (15 U.S.C. 65); and

"(B) any law enacted after the effective date of this paragraph by the Congress which prohibits, or makes available to the United States or any person in any court of the United States any civil remedy with respect to, any restraint upon, or monopolization of, interstate or foreign trade or commerce.

"(36) 'Foreign enterprise' means any corporation at least 20 percent of which is owned by any foreign person, except to the extent that such enterprise provided exchange or interexchange service on January 1, 1982.

"(37) 'General separate subsidiary' means any separate subsidiary of a dominant carrier designated as a general separate subsidiary under section 253 and complying with the requirements of such section.

"(38) 'Information' means knowledge or intelligence represented by any form of writing, signs, signals (including electromagnetic impulses and impulses of light), pictures, sounds, or other symbols.

"(39) 'Inside wiring' means any wiring which—

"(A)(i) connects separately-housed equipment entities or system components to one another; or

"(ii) interconnects any terminal equipment with any regulated facility; and

"(B) is located at the premises of the customer and is not within the housing of any terminal equipment.

"(40) 'Interexchange carrier' means any carrier which provides interexchange transmissions, including any dominant carrier, regulated carrier, or deregulated carrier.

"(41) 'Interexchange transmission' means (A) any transmission among points in more than one exchange area, including the origination and termination of such transmission within each such exchange area; and (B) any transmission relayed by satellite.

"(42) 'International carrier' means any carrier which provides international transmissions, but only to the extent that such carrier provides such transmissions.

"(43) 'International transmission' means any transmission between any point in the United States and any point outside the United States.

"(44) 'Limited separate subsidiary' means any separate subsidiary of a dominant carrier designated as a limited separate subsidiary under section 252 and complying with the requirements of such section.

"(45) 'Own' and 'ownership' mean—

"(A) in the case of any property or other asset, the holding of legal or equitable title of such property or asset, or the exercise of effective control over such property or asset, including through the leasing of such property or asset for a substantial term of years; and

"(B) in the case of a corporation—

"(i) the holding of such percentage of the capital stock of the corporation, or of any class of such capital stock, as may be specified by any provision of this Act;

"(ii) the holding of any portion of the capital stock of the corporation, or of any class of such capital stock, if such holding is sufficient to influence or control the operations of the corporation; or

"(iii) any equivalent form of direct or indirect control of the corporation.

"(46) 'Reciprocal rights' means those rights, terms, and conditions established for United States telecommunications and information services, facilities, or equipment in foreign markets which are reasonably equivalent to those established for foreign enterprises in United States markets, including access to and establishment in such markets.

"(47) 'Regulated carrier' means any telecommunications carrier classified as a dominant carrier or a regulated carrier by the Commission under section 212.

"(48) 'Regulated exchange carrier' means any carrier which is regulated by a State commission and the facilities of which originate or terminate interexchange transmissions.

"(49) 'Regulated facility' means any transmission facility used to provide a regulated service.

"(50) 'Regulated service' means any service designated as a regulated service by the Commission under section 212.

"(51)(A) 'Resale' means any offering, with or without adding value, of any service which is obtained from a carrier. Such term shall not include—

"(i) any service offered by a regulated carrier through the use of facilities which it owns and which are used for regulated services; or

"(ii) any transmission service offered by a separate subsidiary of a dominant carrier.

"(B) 'Reseller' means any person which engages in any resale.

"(52) 'Security' means any financial interest in a corporation, including any interest specified in section 2(1) of the Securities Act of 1933 (15 U.S.C. 77b(1)).

"(53) 'Separate subsidiary' means any general separate subsidiary or limited separate subsidiary.

"(54) 'State commission' means the commission, board, or officials (by whatever name designated) which under the laws of any State have authority to regulate the exchange operations of carriers.

"(55) 'Tariff' means a schedule governing any generally applicable charge, characteristic, regulation, or practice which is filed with the Commission or with any State commission.

"(56) 'Telecommunications' means the transfer of information by electromagnetic impulses (including impulses of light).

"(57) 'Telecommunications carrier' and 'carrier' mean any person which offers any transmission service for profit. Unless the context otherwise requires, such terms shall not include any person engaging in the resale of services which do not substantially use transmission facilities which are owned by such person. Such terms shall include any receiver or trustee owning or administering the assets of a carrier.

"(58) 'Telecommunications facility' means any transmission facility, any terminal equipment, and any facility specified in section 397(13).

"(59) 'Terminal equipment' means any instrument or device which is located on the premises of a person, which is capable, with or without modifications, of originating or receiving electronic transmissions, and which generates, transforms, utilizes, or otherwise processes or makes available information intended for or received from such transmissions.

"(60) 'Transitional joint board' means the transitional joint board established by the Commission under section 273.".

(b)(1) Section 103(7) of the Communications Act of 1934, as so redesignated in subsection (a), is amended to read as follows:

"(7) 'Person' includes the Federal Government, any Federal agency, any State or local government, and any agency of a State or local government.".

(2) Section 103(8) of the Communications Act of 1934, as so redesignated in subsection (a), is amended by striking out "or", and by inserting before the period at the end thereof the following: ", partnership, or other business entity".

APPLICATION OF ANTITRUST LAWS

SEC. 302. (a) The amendments to the Communications Act of 1934 made by this Act shall not be construed—

(1) to create any immunity to any civil or criminal action under any Federal or State antitrust law, or to alter or restrict in any manner the applicability of any Federal or State antitrust law;

(2) to express any intention of the Congress with respect to the issues of liability or appropriate relief, including structural relief, in any antitrust litigation which is pending on the date of the enactment of this Act, or which may be commenced after such date of

enactment, and in which any telecommunications carrier or any affiliate or separate subsidiary of a dominant carrier is a party; or

(3) to limit or affect in any manner the ability of the courts of the United States to determine liability or to grant appropriate relief, including structural relief, in any antitrust litigation in which any telecommunications carrier is a party.

(b) No action brought, or relief granted, under any Federal antitrust law shall be deemed as preventing or interfering with the implementation or enforcement of the Communications Act of 1934.

(c) No authorization or approval by the Federal Communications Commission under the Communications Act of 1934 shall relieve any person from the operation of the Federal antitrust laws or any other restraint or prohibition made by, or imposed under, any authority of law.

TECHNICAL AND CONFORMING AMENDMENTS

SEC. 303. (a) Title I of the Communications Act of 1934 is amended by redesignating sections 4, 5, and 6 as sections 104, 105, and 106, respectively.

(b)(1) The heading for section 101 of the Communications Act of 1934, as so redesignated in section 101, is amended to read as follows:

"ESTABLISHMENT OF COMMISSION; PURPOSES OF ACT".

(2) Section 103 of the Communications Act of 1934, as so redesignated in section 301, is amended—

(A) in paragraph (4) thereof, as so redesignated in section 301, by redesignating subparagraph (1) through subparagraph (3) as subparagraph (A) through subparagraph (C), respectively, and by striking out "section 223" and inserting in lieu thereof "section 512";

(B) in paragraph (17) thereof, as so redesignated in section 301, by redesignating subparagraph (1) through subparagraph (5) as subparagraph (A) through subparagraph (E), respectively, and by redesignating clause (1) through clause (3) as clause (i) through clause (iii), respectively;

(C) in paragraph (19) thereof, as so redesignated in section 301, by redesignating subparagraph (1) and subparagraph (2) as subparagraph (A) and subparagraph (B), respectively; and

(D) in paragraph (20) thereof, as so redesignated in section 301, by redesignating subparagraph (1) and subparagraph (2) as subparagraph (A) and subparagraph (B), respectively.

(3) Section 104(b) of the Communications Act of 1934, as so redesignated in subsection (a), is amended by striking out "the manufacture or sale" and all that follows through

"1952, shall not" and inserting in lieu thereof the following: "or hold any security issued by any telecommunications carrier, any corporation engaged in the manufacture or sale of telecommunications services or facilities, or any other entity owning a significant interest in such a corporation. Commissioners shall not engage in any other business, vocation, profession, or employment, and no Commissioner may".

(4) Section 104(k)(1) of the Communications Act of 1934, as so redesignated in subsection (a), is amended by striking out "interstate and foreign wire and radio communication" and inserting in lieu thereof "interexchange and international transmissions,".

(5) Section 104(o) of the Communications Act of 1934, as so redesignated in subsection (a), is amended by striking out "radio and wire communications" and inserting in lieu thereof "telecommunications".

(6) Section 224(a)(1) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended—

(A) by striking out "The" and inserting in lieu thereof "Subject to section 224(b), the"; and

(B) by striking out "carrier subject to this Act" and inserting in lieu thereof "regulated carrier".

(7) Section 224(a)(2) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended by

inserting "regulated" before "carrier" each place it appears therein.

(8) Section 224(a)(3) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended by inserting "regulated" before "carrier" each place it appears therein.

(9) Section 224(a)(4) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended by inserting "regulated" before "carrier" each place it appears therein.

(10) Section 224(a)(5) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended by striking out "common carriers" and inserting in lieu thereof "any regulated carrier", and by inserting "regulated" before "carrier".

(11) Section 224(a)(6) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended by inserting "regulated" before "carrier" each place it appears therein.

(12) Section 224(a) of the Communications Act of 1934, as so redesignated in section 201(c)(9), is amended by striking out paragraph (7) thereof and by redesignating paragraph (8) thereof as paragraph (7).

(13) Section 224(c) of the Communications Act of 1934, as so redesignated in section 201(c)(12), is amended by strik-

ing out "such carriers" and inserting in lieu thereof "regulated carriers".

(14) Section 224(d) of the Communications Act of 1934, as so redesignated in section 201(c)(12), is amended by inserting "regulated" before "carrier" each place it appears therein.

(15) Section 224(e) of the Communications Act of 1934, as so redesignated in section 201(c)(12), is amended by inserting "regulated" before "carrier" each place it appears therein.

(16) Section 224(h) of the Communications Act of 1934, as added by the amendment made in section 201(b), is amended by striking out "public interest" and all that follows through the end thereof and inserting in lieu thereof "purposes of this title.".

(17) Section 224(i) of the Communications Act of 1934, as so redesignated in section 201(c)(12), is amended by striking out "any carrier" and inserting in lieu thereof "the regulated carrier".

(18) Section 225(a)(1) of the Communications Act of 1934, as so redesignated in section 201(c)(10), is amended—

(A) by inserting "regulated" before "carrier" the first place it appears therein;

(B) by striking out "line" each place it appears therein and inserting in lieu thereof "facility";

(C) by striking out "present or future public convenience and necessity" and inserting in lieu thereof "purposes of this title";

(D) by striking out "State" and inserting in lieu thereof "exchange area";

(E) by striking out "interstate" and inserting in lieu thereof "interexchange";

(F) by striking out "221 or 222" and inserting in lieu thereof "266"; and

(G) by striking out the second and last sentences thereof.

(19) Section 225(a)(2) of the Communications Act of 1934, as so redesignated in section 201(c)(10), is amended by striking out "line" and inserting in lieu thereof "facility".

(20) Section 225(a)(3) of the Communications Act of 1934, as so redesignated in section 201(c)(10), is amended—

(A) by striking out "line" and inserting in lieu thereof "facility";

(B) by striking out "public convenience and necessity" and inserting in lieu thereof "purposes of this title";

(C) by inserting "regulated" before "carrier"; and

(D) by striking out "section" and inserting in lieu thereof "subsection".

(21) Section 225(a)(4) of the Communications Act of 1934, as so redesignated in section 201(c)(10), is amended—

(A) by inserting "regulated" before "carrier" each place it appears therein;

(B) by striking out "common";

(C) by striking out "line" and inserting in lieu thereof "facility"; and

(D) by striking out "in the interest of public convenience and necessity" and inserting in lieu thereof "to carry out the purposes of this title".

(22) Section 225(b)(1) of the Communications Act of 1934, as so redesignated in section 201(c)(11), is amended—

(A) by striking out "common carrier" and inserting in lieu thereof "regulated carrier";

(B) by inserting "regulated" before "carrier" each place it appears therein;

(C) by inserting "transmission" before "services" the second place it appears therein;

(D) by striking out ", in wire or radio communications subject to this Act,"; and

(E) by inserting "transmission" before "service" the first place it appears therein.

(23) Section 225(b)(3) of the Communications Act of 1934, as so redesignated in section 201(c)(11), is amended—

(A) by striking out "common carriers subject to this Act" and inserting in lieu thereof "regulated carriers"; and

(B) by striking out "another common carrier subject to this Act" and inserting in lieu thereof "any other such carrier".

(24) Section 229 of the Communications Act of 1934, as so redesignated in section 201(c)(7), is amended—

(A) by striking out "common" the first place it appears therein and inserting in lieu thereof "regulated"; and

(B) by striking out "other common".

(25) Section 232(e)(1)(A) of the Communications Act of 1934, as so redesignated in section 201(c)(15), is amended by striking out "wire communication" and inserting in lieu thereof "the provision of transmission service".

(26) Section 264 of the Communications Act of 1934, as so redesignated in section 201(c)(1), is amended—

(A) by striking out "interstate or foreign communication by wire or radio" and inserting in lieu thereof "international telecommunications"; and

(B) by striking out "communication" the last place it appears therein and inserting in lieu thereof "telecommunications".

(27) Section 265(c) of the Communications Act of 1934, as so redesignated in section 201(c)(8), is amended—

(A) by striking out "After sixty days from the enactment of this Act, it" and inserting in lieu thereof "It";

(B) by striking out "carrier subject to this Act" each place it appears therein and inserting in lieu thereof "regulated carrier";

(C) by inserting "regulated" before "carrier" the second place it appears therein; and

(D) by inserting "regulated" before "carriers" each place it appears therein.

(28) Section 303(r) of the Communications Act of 1934 is amended by striking out "radio or wire communications" and inserting in lieu thereof "telecommunications".

(29) Section 406 of the Communications Act of 1934 is amended—

(A) by striking out "carrier subject to this Act" and inserting in lieu thereof "regulated carrier";

(B) by striking out "service in interstate or foreign communication by wire or radio" and inserting in lieu thereof "any interexchange or international transmission";

(C) by inserting "any service" before "in interstate" the last place it appears therein; and

(D) by striking out "communication" the second and last places it appears therein and inserting in lieu thereof "telecommunications".

(30) Section 407 of the Communications Act of 1934 is amended by inserting "regulated" before "carrier" each place it appears therein.

(31) Section 410(a) of the Communications Act of 1934 is amended by striking out "wire or radio communication" and inserting in lieu thereof "provision of telecommunications service".

(32) The first sentence of section 410(c) of the Communications Act of 1934 is amended—

(A) by striking out "The" and inserting in lieu thereof "After the termination of the transitional joint board under section 273(i), the"; and

(B) by striking out "interstate and intrastate operations" and inserting in lieu thereof "interexchange and exchange transmission service".

(33) Section 412 of the Communications Act of 1934 is amended—

(A) by striking out "common carriers" and inserting in lieu thereof "regulated carriers";

(B) by inserting "regulated" before "carriers" the last place it appears therein; and

(C) by striking out "foreign wire or radio communication" and inserting in lieu thereof "international transmissions".

(34) Section 413 of the Communications Act of 1934 is amended by inserting "regulated" before "carrier" each place it appears therein, and by striking out "subject to this Act".

(35) Section 415(a) of the Communications Act of 1934 is amended by inserting "regulated" before "carriers".

(36) Section 415(b) of the Communications Act of 1934 is amended by inserting "regulated" before "carriers".

(37) Section 415(c) of the Communications Act of 1934 is amended—

(A) by inserting "regulated" before "carriers"; and

(B) by inserting "regulated" before "carrier".

(38) Section 415(d) of the Communications Act of 1934 is amended by inserting "regulated" before "carrier" each place it appears therein.

(39) Section 415(e) of the Communications Act of 1934 is amended by inserting "regulated" before "carrier".

(40) Section 416(a) of the Communications Act of 1934 is amended by striking out "carrier" and inserting in lieu thereof "regulated carrier involved".

(41) Section 502 of the Communications Act of 1934 is amended by striking out "radio or wire communications" and inserting in lieu thereof "telecommunications".

(42) Section 503(a) of the Communications Act of 1934 is amended—

(A) by striking out "interstate or" the first place it appears therein and inserting in lieu thereof "transmission between exchange areas or for";

(B) by inserting "regulated" before "carrier" the first and second places it appears therein;

(C) by striking out "interstate or foreign wire or radio" and inserting in lieu thereof "interexchange or foreign"; and

(D) by striking out "common carrier" and inserting in lieu thereof "regulated carrier".

(43) The heading for section 511 of the Communications Act of 1934, as so redesignated in section 201(c)(2), is amended by inserting "REGULATED" before "CARRIERS".

(44) Section 511(a) of the Communications Act of 1934, as so redesignated in section 201(c)(2), is amended by striking out "common carrier" each place it appears therein and inserting in lieu thereof "regulated carrier".

(45) Section 511(c) of the Communications Act of 1934, as so redesignated in section 201(c)(4), is amended—

(A) by striking out "common carrier subject to the provisions of this Act" and inserting in lieu thereof "regulated carrier"; and

(B) by striking out "common carrier" the last place it appears therein and inserting in lieu thereof "regulated carrier".

(46) Section 511(d) of the Communications Act of 1934, as so redesignated in section 201(c)(5), is amended—

(A) by striking out "common carrier subject to this Act" and inserting in lieu thereof "regulated carrier";

(B) by striking out "common carrier" the second, third, and last places it appears therein and inserting in lieu thereof "regulated carrier"; and

(C) by striking out "carrier or carriers" and inserting in lieu thereof "regulated carrier".

(47) Section 511(e) of the Communications Act of 1934, as so redesignated in section 201(c)(6), is amended by striking out "carrier" and inserting in lieu thereof "regulated carrier involved".

(48) Section 512 of the Communications Act of 1934, as so redesignated in section 201(c)(14), is amended by inserting the following new heading at the beginning thereof:

"PROHIBITION OF CERTAIN TELEPHONE CALLS".

(49) Section 512(1) of the Communications Act of 1934, as so redesignated in section 201(c)(14), is amended by striking out "in the District" and all that follows through "by means of telephone" and inserting in lieu thereof "by means of telephone in the District of Columbia, between exchange areas, or between an exchange area and a point in a foreign nation".

(50) Section 605 of the Communications Act of 1934 is amended—

(A) by striking out "interstate or foreign communication by wire or radio" and inserting in lieu thereof "transmissions between exchange areas, or between an exchange area and any point in a foreign nation,"; and

(B) by striking out "communication" the second and third places it appears therein and inserting in lieu thereof "telecommunication".

(51) Section 606(b) of the Communications Act of 1934 is amended—

(A) by striking out "interstate or foreign communication by radio or wire" and inserting in lieu thereof "telecommunications between exchange areas, or between an exchange area and any point in a foreign nation"; and

(B) by striking out "communication" the last place it appears therein and inserting in lieu thereof "telecommunications".

(52) Section 606(d)(2) of the Communications Act of 1934 is amended by inserting "transmission" before "facility", and by striking out "for wire communication".

AUTHORIZATION OF APPROPRIATIONS

SEC. 304. There is authorized to be appropriated such sums as may be necessary to carry out this Act and the amendments made by this Act.

EFFECTIVE DATE

SEC. 305. The provisions of this Act shall take effect on the date of the enactment of this Act.

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Mr. WIRTH. Again, I welcome our distinguished panelists.

Mr. Scheuer.

Mr. SCHEUER. First, I would like to congratulate you for your leadership on having these hearings, both on the Wirth bill and implications of the A.T. & T. settlement.

I would like to thank the many chairmen of the State commissions for appearing before us. Mr. Chairman, last week we heard from the principal participants in this tangled case involving the antitrust settlement. We heard from the chairman of A.T. & T. and the Assistant Attorney General, Mr. Baxter. Mr. Baxter told us that local service is demand inelastic, that there would not be much of a response one way or another from consumers as rates go up or in the mythical event that they went down, there would not be any expansion. There would not be a contraction when rates go up. I think this is something about which we definitely want to hear from the commissioners.

Mr. Brown speaking for A.T. & T. said that local rates could double or even treble without having the elderly or the poor leave the telecommunications network. He mentioned that telephone was cheaper than pizza. Well, the question is are the poor and the elderly, particularly, who depend on the telephone as their communications link with the outside world, are they going to have to ration their life diet, to give up both pizza and communications?

That is something we urgently want to hear about. I am disturbed about Mr. Baxter's and Mr. Brown's statements concerning the effects of the increase on the poor, and particularly the elderly, who are not mobile, who in the case of a fall, a broken hip, or a sudden illness, a temperature, an infection, or in the event of an urgent catastrophe such as the cutoff of heat, are in desperate need to communicate with the outside world via the telephone.

They are not ambulatory as younger poor people are. And I do not think that Mr. Brown and Mr. Baxter adequately represented the precarious position of the elderly poor as they would be impacted by rate increases.

Bell's own exhibit from the antitrust trial projects that 30 percent of all American households will be deprived of basic local telephone service if rates are increased by 200 percent, that is, if they are trebled, as many serious experts tell us is in the cards, a great possibility.

These are appalling estimates which in my mind underscore the pitiful situation facing older Americans who are disproportionately poorer and disproportionately more dependent upon telephone service than the population as a whole. This 200-percent increase, or a trebling of phone services according to Bell's own estimates, would reduce the percentage of moderately poor people with basic telephone service from 84 percent to 53 percent and reduce basic telephone services for the very poor from almost four-fifths, 79 percent, to less than a half, 46 percent.

In other words, according to Ma Bell's own statistics, over half of the elderly households who are living on the knife edge of poverty would be denied their life link to the outside world if the kind of cost increases we have heard about from responsible, thoughtful experts comes true.

This agreement, this consent decree may spell disaster for the four out of five elderly couples whose median income is less than $15,000.

Mr. Chairman, in deference to the witnesses and other members, I do not wish to carry on. But we must explore this consent decree. The Wirth bill is an excellent vehicle, and I think it is up to us to make sure that it contemplates the real needs of our population who are desperately dependent upon continuous phone service that they can afford.

Thank you very much, Mr. Chairman.

Mr. **Wirth**. Thank you, Mr. Scheuer.

If our panelists might introduce themselves, I think you are all familiar with the rules of the subcommittee. What we will try to do is have you summarize your testimony in 5 minutes, have a chance to comment on what each other has said, then get into questions and answers if we might.

If we could start with you introducing yourselves for the record for the purpose of the reporter, Mr. Hipp, and then begin with Mr. Edward Burke who is not only chairman of the Rhode Island Public Utilities Commission, but president of the National Association of Regulatory Utility Commissioners.

Mr. **Hipp**. Mr. Chairman, my name is Edward B. Hipp, I am a commissioner on the North Carolina Utilities Commission from Raleigh, N.C.

Mr. **Cresse**. Mr. Chairman, I am Joe Cresse, chairman of the Florida Public Service Commission.

Mr. **Bryson**. Mr. Chairman, I am John Bryson, president of the California Public Utilities Commission.

Mr. **Schneidewind**. Mr. Chairman, I am Eric Schneidewind, chairman of the Michigan Public Service Commission.

Mr. **Burke**. And, as advertised, I am Ed Burke, chairman of the Rhode Island Utilities Commission.

Mr. **Wirth**. Pull the microphone over.

STATEMENTS OF EDWARD F. BURKE, CHAIRMAN, RHODE ISLAND UTILITIES COMMISSION; ERIC J. SCHNEIDEWIND, CHAIRMAN, MICHIGAN PUBLIC SERVICE COMMISSION; JOHN E. BRYSON, PRESIDENT, CALIFORNIA PUBLIC UTILITIES COMMISSION; JOSEPH P. CRESSE, CHAIRMAN, FLORIDA PUBLIC SERVICE COMMISSION; AND EDWARD B. HIPP, COMMISSIONER, NORTH CAROLINA UTILITIES COMMISSION

Mr. **Burke**. I think for the record—again, I am Ed Burke, president of NARUC and chairman of the Rhode Island Public Utilities Commission. I think at the outset for those who are not aware, all of the colleague commissioners who are present today are members of NARUC, which is the National Association of Regulatory Utility Commissioners. We are a quasi-governmental and nonprofit organization which was founded in 1889. Within our membership are governmental agencies of the 50 States, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands engaged in the regulation of utilities and carriers.

Our chief objective is to serve the consumer interest by seeking to improve the quality and effectiveness of public regulation in

America. We want to thank you, Mr. Chairman, and members of the committee for affording us this opportunity today to make known our views on H.R. 5158, a bill proposing the Telecommunications Act of 1981.

My remarks are in print and have been distributed to the committee. I would just like to highlight a couple of events that have taken place since this invitation. I decided that the events of the last few weeks were so complicated and complex that it was appropriate to attempt to run a workshop for those State commissions that might be interested.

We had a very small time in which to prepare this. But yesterday, I am happy to say, we did, at our headquarters here in Washington, hold a workshop at which Mr. Baxter, Mr. Aylward of your committee, Mr. Bolter, Mr. White from the appropriate Senate committee, and Mr. Partoll, vice president of A.T. & T. appeared. But I think more significantly is the fact that 39 of our 54 jursidictions were represented by commissioners.

There were over 100 commissioners and commission staff present. Our distinguished attorney general, Dennis Roberts of Rhode Island, who is a member of the National Association of Attorneys General appeared representing that group. There were other consumer groups present. I think that this outpouring of interest shows that there is concern, there is concern all across this country about the possible effects of the proposed settlement between A.T. & T. and the Justice Department. The kind of concern which I talk in large measure H.R. 5158 attempts to meet.

This does not mean that we feel that the legislation is perfect at this point. We certainly feel that there are appropriate amendments. My colleagues here today will speak to many of these issues. But I think that we are concerned because it has always been in a NARUC's position that it is most important to the United States that there be a continued commitment to universal affordably priced telephone service and to increased competition where feasible.

That is what I think H.R. 5158 attempts to speak to.

There are five key items that I would just like to stress. We feel that there should be retention of the proposed Federal/State joint board intended to oversee the transition to the access change contribution for local service beyond the bill's 5-year period.

Yesterday after the meeting, I submitted my testimony to my 39 colleagues. The only point which they asked me on change related to the fact that the consensus of the Communications Committee at least was that they felt there should be a majority, naturally, of State regulators on the joint board.

However, I do think that the proposal, as you have it, goes a long way. A small technical item, and that is, if there is to be a joint board with the kind of jurisdiction we envision, I think it is important that at least the expenses of the members of the joint board be covered.

No one wants to be paid, but we are in the middle of a budgetary crunch all across this country. If the joint board is to fulfill its functions, it is going to be necessary for the State members of the joint board to participate.

We feel that there should be within the bill clarification of the State's comprehensive jurisdiction over exchange transmission service.

We feel there should be continued jurisdiction over interstate interchange service beyond the 5-year period envisioned under the legislation.

We feel there should be continued regulation of resale and shared use of any transmission services in view of State authorities' optimal position to evaluate local conditions and consumers' needs and interests.

Finally, we feel there should be a continuation of State authority to consider directory advertising, yellow page revenues for ratemaking purposes. This is a plus.

This is a $2 billion plus annual revenue. We don't think it should be sold on a one-time basis. We think the revenues from the yellow pages should be considered on a permanent basis as part, at least until, you know, there could be technological changes down the line that would make yellow pages obsolete.

But that is not the case at this point. One last item, Mr. Chairman, is that the Communications Committee yesterday and several people who speak to this, Commissioner Schneidewind was instrumental in the moving of this resolution, feel very strongly that A.T. & T. should be required within its—within the settlement case, which we are not really addressing today, but we can't do this in a vacuum, we feel very strongly that there has to be careful supervision of that settlement and we feel that the operating companies as corporate entities ought to be spun off in that case before there is an exchange of assets.

We are fearful that if the assets are transferred first, we may end up with local companies that are not really capable of doing the job that they should do.

That basically, those basically are my remarks, and I will be happy subsequently to answer questions.

[Testimony resumes on p. 139.]

[Mr. Burke's prepared statement follows:]

STATEMENT OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Mr. Chairman and Members of the Subcommittee:

My name is Edward F. Burke. I am the President of the National Association of Regulatory Utility Commissioners, commonly known as the "NARUC." I am also the Chairman of the Rhode Island Public Utilities Commission and have served in such capacity since January 14, 1977. Accompanying me today are Paul Rodgers, NARUC Administrative Director and General Counsel; Deborah A. Dupont, NARUC Deputy Assistant General Counsel; and Rita A. Barmann, NARUC Director of Congressional Relations.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within our membership are the governmental agencies of the fifty States and the District of Columbia, Guam, Puerto Rico, and the Virgin Islands engaged in the regulation of utilities and carriers. Our chief objective is to serve the consumer interest by seeking to improve the quality and effectiveness of public regulation in America.

The members of the NARUC appreciate your invitation to make known their views on H.R. 5158, a bill proposing the Telecommunications Act of 1981.

We are very pleased that the legislation supports a continued commitment to universal, affordably priced service and to increased competition where such deregulation is feasible and beneficial to consumers and the industry. While the NARUC has supported such legislative goals in the past, their enactment now are of paramount public concern and urgency because of the AT&T antitrust settlement agreement announced on January 8, 1982. Its implementation, unattended by remedial Congressional legislation, could result in precipitous and unnecessary increases in local telephone rates and substantial encroachment upon Federal and State regulatory jurisdiction.

To achieve our mutual goals in communications reform, we respectfully submit several amendments to the proposed Telecommunications Act of 1981, which are summarized as follows.

Exchange Access Fees, National Telecommunications Fund and the Federal-State Joint Board

The twin goals of the legislation--universal service at affordable rates and the promotion of competition--could become mutually destructive unless these competing interests are delicately balanced in whatever legislation is eventually enacted. The key ingredient in the balance is the configuration of the administrative body which will determine the level of contribution by interexchange telecommunications for the use of exchange facilities. Substantial discretion, within the context of general Congressional guidelines, must be left to the administrative body in making this determination because of the rapidly changing technology of the communications industry.

Today this contribution to local service is made through the separations process and under any new legislation it will be made through the access charge. Under either concept the same basic economic needs will have to be met for preserving local service at affordable rates. Moreover, access charge formulas, like the separations process, will require periodic revision to address changing usage and technology.

In the late sixties the introduction of new technology, such as improved coaxial cable and microwave, substantially reduced the cost of long distance circuits. This trend continues today with no end in sight. In contrast, there has been no such technological breakthrough in the furnishing of local service and hence its cost has steadily increased due to inflation.

Understandably, the FCC, as the interstate ratemaker, has taken advantage of the cost-cutting technology by keeping interstate rates relatively stable during a high inflationary period. This is reflected by Table 1 which shows that the Bell System interstate rate index enjoyed a modest increase of 100.00 to 120.0 from 1967 to 1981, while the intrastate rate index soared from 100.00 to 177.0 for the same period. Another way of reflecting this disparity is shown by an intrastate dialed call between Seattle and Spokane, Washington, a distance of 232 miles, costing $1.08, while an interstate dialed call between New York City and Los Angeles, a distance of 2,452 miles, costs $1.58 (3 minute, station-to-station, dialed day rate).

Table 2 reflects that these unfortunate consequences for local users cannot be attributed to any laxity on the part of State regulators because the Bell System level of earnings under State regulation is lower in each year than it is under FCC regulation.

Such rate consequences were not inevitable since the FCC could have ameliorated the impact on local users by approving greater changes in the separations process, thereby sharing with them more effectively the cost-saving technologies in long distance calling. After all, long distance calls cannot be completed without the use of local facilities and, therefore, economies occurring in long distance calling should be shared with the local users. This concept is the major underpinning of the universality of service principle.

Human nature being what it is we are fearful that the FCC will continue to favor its role in interexchange ratemaking under the new legislation, thereby relegating to the State commissions the announcement of the "bad news" in their rate decisions which will be preordained by the access charge formula dictated by the FCC. Moreover, it is quite likely that the traditional FCC attitude in this area will be further intensified under the new legislation since it will be required to actively promote competition as a part of national communications policy.

Accordingly, the State regulatory community is very pleased that the legislation would establish an administratively final joint board, composed of three FCC commissioners and two State commissioners, to administer the National Telecommunications Fund and to modify existing jurisdictional separation and settlement procedures to permit an orderly transition to the system of exchange access fees.[1] Sec. 273, pp. 70-76. Since Congressional guidance is quite explicit with respect to the formulation of exchange access fees, their establishment and administration should also be entrusted to the joint board.[2]

The legislation strongly emphasizes the universality of service concept[3] which of course is predicated on affordable rates for the vast majority of the people. However, the level of contribution by

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1/ However, we respectfully recommend that Section 273(d) be amended, to authorize Commission reimbursement of the State members' expenses while participating in joint board activities, by adding the following sentence at the end of line 21, page 71: "The State members of any joint board established under Section 410(c) shall be allowed travel expenses, including per diem in lieu of subsistence, in the same manner as persons employed intermittently in Government service are allowed expenses under section 5703 of title 5, United States Code." The same provision appears in Section 222(b)(2) of S. 898, a bill purposing the Telecommunications Competition and Deregulation Act of 1981, p. 65, lines 9-14.

2/ This amendment may be made by striking "Commission" wherever it appears in Section 233 and inserting in lieu thereof "transitional joint board". Pages 26-31. Also, "may" should be changed to "shall", p. 30, line 24, since the delegation should be mandatory to a willing State commission which complies with the law. This would minimize the Federal presence and funding without loss of Federal policy direction.

3/ Sec. 101(b)(1)(3), p. 2, lines 13-15, 20-22; Sec. 201(a), p. 5, lines 6-8; Sec. 201(c)(1), p. 6, lines 5-7; Sec. 221(b)(2), p. 14, lines 12-14; Sec. 233(a)(b), p. 28, lines 1-3; Sec. 281(1), p. 88, lines 1-3.

interexchange customers for the use of exchange services and facilities will be sharply reduced after the three year transition period as a result of the access fee formula established by Section 233(c), p. 29, and irrespective of the operation of the National Telecommunications Fund (NTF), Sec. 234, pp. 32-36. Accordingly, the third account under the NTF, to ease the transition away from existing jurisdictional separation and settlements procedures, should be revised to provide the wherewithal for a permanent commitment to the universality of service concept so strongly enuciated in the bill.[4/]

While we heartily support the configuration of the transitional joint board, we respectfully oppose its termination at the end of five years since matters entrusted to it will always require periodic review and revision.[5/] Surely, if the board can be relied upon to handle the problem-prone transition, it can with greater confidence be relied upon to perform effectively in the post-transition period.

The most important communication rate in America, both politically and economically, is the basic monthly rate paid by a residential user for telephone service. If the rate becomes too high, more and more residential users, especially in rural areas, will lose their telephone service. If this happens the public retribution against the Congress and the regulatory community will be severe.

An effective means to guard against the occurrence of such a possibility is the continuation of the bill's joint board with two

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[4/] This amendment may be made by striking "pro-" from line 14 and striking lines 15-23 from page 34 and inserting in lieu thereof: "ensure the continued universal availability of telecommunications services provided by exchange carriers at reasonable and affordable rates.".

[5/] The amendment may be made: by striking Section 273(i), page 76, lines 9-13; and by striking "transitional joint board" wherever it appears in the bill and inserting in lieu thereof "permanent joint board".

voting State commissioners, who can be depended upon to always champion the interests of those who use local telephone service. The protection of Federal interests will of course be assured by a majority of FCC members and by judicial review being in the Federal courts. Nevertheless, a strong minority State voice in the formulation and revision of access fees and support from the National Telecommunications Fund is bound to benefit local users and the intent of Congress.

The critical dimension--the most vulnerable aspect--of the legislation is the protection of urban and rural residential users. They must not become the "cannon fodder" in the growing battle of competing industry interests.

Clarification of State Jurisdication Over Exchange Transmission

We deeply appreciate the author's intent under H.R. 5158 to reserve to the States comprehensive jurisdiction over exchange transmission service as reflected by Section 231(a), page 23, lines 8-11. However, this reservation of State jurisdiction is impaired by a very broad and vague exception: "Except as otherwise provided in this title". This exception should either be deleted or precisely defined to avoid unintended preemption of the State role by the FCC.[6]

State Regulation of Intrastate Interexchange Service Comparable to FCC Regulation of Interstate Interexchange Service

Consistent with the protection of the public interest, the bill provides for the continued full regulation of interexchange telecommunications services by regulated carriers [Sec. 102(1), p. 4; Sec. 226, pp. 18-21], with State regulation of intrastate interexchange service to be continued for five years after enactment and then to be transferred to the FCC (Sec. 274, p. 76). Since the substantial State regulatory mechanism is already in place for the regulation of intrastate interexchange service, we believe it should be permitted to continue to operate beyond the five years where comparable with the FCC regulatory program for interstate interexchange service.

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[6] In the event the exception is retained, it should be revised to read: "Except as otherwise expressly provided in Sections 214, 241, 242, 272 and 275". Also, Section 102(2), page 4, lines 11-13, should be deleted since it is a confusing duplication of the exception contained in Section 231(a).

Our amendment would not frustrate the intent to stimulate maximum competition in the interexchange area, but would merely utilize existing State resources in carrying on the needed regulatory program, thereby eliminating the need to increase the FCC staff and preserving the convenient State forums to hear and resolve consumer grievances.[7/]

Continued State Regulation of Resale of Telecommunications Service

The bill would preclude the FCC and the State commissions from further regulation of the resale or shared use of any transmission services. Sec. 211(c) p. 8, lines 1-3.

The NARUC urges that the State commissions continue to have the option to regulate resale and shared use operations since the State regulatory authorities are optimally positioned to determine and evaluate local conditions and the needs and interests of consumers.[8/]

[7/] "During Transition" should be stricken from page 76, line 15, and Section 274, page 76, lines 16-20, should be revised to read: "No provision of this Act shall empower the Commission to regulate the rates or service of a regulated carrier for providing interexchange telecommunications service between points within a single State when such rates and service are regulated by a State commission.".

[8/] This amendment may be accomplished by striking from page 8, line 1, "Neither the Commission nor any State may" and inserting in lieu thereof "The Commission may not". Also, the period at the end of Section 222(a), page 14, line 22, should be stricken and the following inserted in lieu of the period: ", unless authorized by a State commission.".

Continuation of State Authority to Consider Directory Advertising Revenue for Ratemaking Purposes

The bill provides that no State commission shall have any authority to consider for ratemaking purposes revenues derived from unregulated products or services by any affiliate or subsidiary of a regulated carrier. Sec. 211(b), p. 7, lines 7-24; Sec. 263(e)(3), lines 9-16. State commissions have long considered unregulated directory advertising ("Yellow Pages") revenue to offset other costs in telephone rate cases. See Table 3.

The Yellow Pages advertising is an integral part of our telephone service since it is annually reissued to each telephone customer. We are all aware of the fleeting advertisements on television and radio and in newspapers and magazines, but only the Yellow Pages are always there, everywhere, day-after-day.

The Yellow Pages have no direct competition. This powerful medium is "made" by the telephone customer and he or she should continue to reap the benefits on the telephone bill.

Revenue from directory advertising is no minor item: in 1980 the Bell System alone obtained approximately $2.619 billion in directory advertising revenue. This, of course, does not include the advertising revenue received by the independent telephone companies. Removing this revenue from State ratemaking will significantly increase local rates. Adoption of our amendment will nullify this anti-consumer aspect of the bill. 9/

9/ The amendment may be made by striking the period at the end of Section 211(b), page 7, line 24, and inserting in lieu of such period: "; except that any State commission may take into account for ratemaking purposes revenues derived from printed directory advertising which function shall remain with the regulated carrier."

We recognize that under the bill the Yellow Pages would be valued at "the fair market value...including the value of the business as a going concern" upon transfer from the regulated carrier to an unregulated affiliate or subsidiary. Sec. 273(j)(2)(A), p. 74, lines 5-9. However, the proceeds derived from this one time valuation will pale in comparison with the continual annual infusion of Yellow Pages revenue for the benefit of local ratepayers. To dispose of such a profitable enterprise is like the man in Aesop's Fable who killed the Goose that laid the Golden Eggs!

Other Features of Federal-State Cooperation

The NARUC strongly supports other features of the legislation which:

(1) Continue State jurisdiction to establish exchange areas subject to general guidelines and review by the transitional joint board;

(2) Authorize the State commissions to obtain information from all carriers and others [Sec. 232(f), p. 26, lines 14-21]; and

(3) Retain substantial State regulation over embedded terminal equipment and inside wiring during the transition (Sec. 272, pp. 66-70).

We also support the empowering of the transitional joint board to determine, at fair market value, the value of assets transferred by regulated carriers to subsidiaries or for use in unregulated activities [Sec. 273(a)(1)(f), pp. 70, 73-75], although we would prefer that assets under State jurisdiction be valued by the respective State commissions. Otherwise, the role of the transitional joint board should be expanded to include the valuation of assets (under FCC or joint FCC-State jurisdiction) which are proposed for transfer.[10/]

[10/] This amendment may be made by striking "Commission" from Section 275(c)(1), page 78, line 7, and inserting in lieu thereof "transitional joint board".

We support the establishment of a Federal-State joint board in accordance with Section 410(c) to foster cooperation (Sec. 235, p. 36), and respectfully urge that its scope be expanded to aid the FCC in the performance of its duties with respect to interconnection (Sec. 214, pp. 12-13), and terminal equipment and inside wiring (Sec. 242, pp. 37-39).[11/]

Increasing Federal-State Cooperation by Expanding Use of Section 410(c) Joint Board

Section 410(c) of the Communications Act [47 U.S.C., Sec. 410(c)] provides that the FCC shall refer any proceeding regarding the separation of telephone company property and expenses between Federal and State jurisdiction, and may refer any other proceeding of joint Federal-State concern, to a Federal-State joint board composed of three FCC commissioners and four State commissioners. The joint board decision is advisory in nature because it is subject to review and revision by the FCC without any State voting participation.

A major problem has been that the FCC has frequently refused to exercise its discretionary power to refer matters to a joint board irrespective of their great concern to the State commissions. Our amendment would solve the problem by making the discretionary referral mandatory when requested by two-thirds of the affected State commissions within 45 days after the institution of the proceeding by the FCC.[12/]

[11/] This amendment may be made by striking the period at the end of Section 235, page 36, line 23, and inserting in lieu of the period:"; and to assist the Commission in the performance of its duties under Sections 214 and 242.".

[12/] The amendment may be made by striking the period at the end of the first sentence of Section 410(c) and inserting in lieu of such period: "; provided that such discretionary referral shall become mandatory when requested by two-thirds of the affected State commissions within 45 days after public notice is given of the institution of the matter.".

Conclusion

In conclusion, we believe the adoption of these amendments will strengthen the ability of the legislation to accomplish its goals of providing better communications service for all Americans.

Thank you.

Table 1

Telephone Rates Bell System
(1967 = 100)

Year	Intrastate	Interstate
1960	102.8	107.4
1961	103.0	107.3
1962	102.3	107.3
1963	102.2	106.1
1964	101.9	106.0
1965	100.9	102.9
1966	100.3	102.8
1967	100.0	100.0
1968	100.9	100.6
1969	101.7	100.8
1970	106.3	97.7
1971	112.2	100.5
1972	117.9	100.9
1973	125.3	102.6
1974	130.1	102.5
1975	140.2	106.9
1976	146.2	109.3
1977	151.5	109.8
1978	154.7	109.7
1979	160.1	109.2
1980	168.4	112.4
1981 (estimated)	177.0	120.0

Source: American Telephone & Telegraph Company, Tariffs and Costs Department.

Table 2

Rates of Net Operating Income to
Average Net Book Cost of Telephone
Plant of Bell System Companies

Year	Bell System Operating Companies (Excl. Long Lines)	Long Lines Department
1965	7.51	8.38
1966	7.66	8.74
1967	7.64	8.59
1968	7.29	7.76
1969	7.31	8.30
1970	7.27	7.46
1971	7.06	7.72
1972	7.35	7.53
1973	7.71	8.23
1974	7.79	8.04
1975	7.61	8.20
1976 (unreported)		
1977	8.17	8.75
1978	8.57	9.32
1979	8.40	9.30
1980	8.50	9.20

Source: Federal Communications Commission.

The following table was prepared from responses to the following questions: Table 3

1. Does your Agency consider telephone directory advertising ("Yellow-Pages") revenues for ratemaking purposes? Yes____. No. ____.

2. If "yes", how much net revenue (after taxes) was derived from directory advertising and applied in ratemaking: $_________ from Bell System companies for the year ended _________, 19__? $_________ from other telephone companies for the year ended ________, 19__?

3. If "yes", how much gross revenue (before taxes) would be necessary to replace the loss of directory advertising revenue for ratemaking purposes: $ _________ from all telephone companies for the year ended _________, 19__? $_________ average per main station per month?

Example: In the State of North Carolina in 1980, Southern Bell Telephone Company's net revenues from directory advertising were $6.8 million while its gross revenues from this source were $14 million. With one million customers in North Carolina, the $14 million gross revenue requirement would have increased a subscriber's bill about $1.17 per month if the directory advertising revenue had not been applied in ratemaking.

USE OF TELEPHONE DIRECTORY ADVERTISING REVENUES IN STATE RATEMAKING

Name of Agency	Considers Directory Advertising Revenue for Ratemaking	Net Revenue Derived from Directory Advertising and Applied in Ratemaking: Bell System	Net Revenue Derived from Directory Advertising and Applied in Ratemaking: Other Telephone Companies	Gross Revenue Necessary to Replace Loss of Directory Advertising Revenue for Ratemaking	Increase In Subscriber's Monthly Bill If Directory Advertising Revenue Not Applied in Ratemaking	Fiscal Year Ended
Alabama PSC	yes			22,692,000 5/	1.61	
Alaska PUC	yes			4,000,000 1/	5.50	12/31/80
Arizona CC	yes	26,410,000				
Arkansas PSC				--		
California PUC	yes	121,600,000	41,400,000 6/		1.25	
Colorado PUC	yes	12,175,000		23,668,000 2/	1.59	12/31/80
Connecticut PUCA						
Delaware PSC	yes	1,900,000		3,900,000	1.38	12/31/80
District of Columbia PSC	yes	2,500,000		5,900,000	.71	12/31/80
Florida PSC	yes	35,300,000	13,700,000	98,000,000	1.81	12/31/80
Georgia PSC						
Guam PUC						
Hawaii PUC	yes		4,887,821	8,969,700	1.86	12/31/80
Idaho PUC	no					
Illinois CC	yes	57,293,589			1.08	12/31/80
Indiana PSC	yes	12,127,320			1.51	12/31/80
Iowa SCC	yes	11,556,761		23,231,501 5/	2.04	12/31/80
Kansas SCC	yes	9,666,000	197,000	20,135,000 3/	2.01	6/30/81
Kentucky PSC	yes	4,389,447	1,620,922	11,840,756	.75	12/31/80
Louisiana PSC	yes	9,913,820	419,572	37,906,085	1.86	12/31/80
Maine PUC						
Maryland PSC	yes.	14,250,795		30,713,042	1.46	12/31/80
Massachusetts DPU						
Michigan PSC	yes	37,528,927	2,431,845	74,001,430	1.73	12/31/80
Minnesota PUC	yes					
Mississippi PSC	yes					
Missouri PSC	yes			63,938,578	2.51	12/12/80
Montana PSC	yes	1,450,000		2,940,000	.92	6/30/80
Nebraska PSC	yes					
Nevada PSC	yes			21,015,746		12/31/80
New Hampshire PUC						
New Jersey BPU	yes	27,200,000		52,700,000	1.35	12/31/60
New Mexico SCC	no 4/					
New York PSC	yes	32,000,000	3,200,000	65,000,000	.75	12/31/80
North Carolina UC	yes	7,528,746	7,500,000	31,000,000	1.14	5/31/81
North Dakota PSC	yes	2,719,124	906,812	6,351,690	1.93	12/31/80
Ohio PUC	no					
Oklahoma CC						
Oregon PUC	yes	20,574,000	4,869,000	38,041,000	2.81	12/31/80
Pennsylvania PUC	yes					
Puerto Rico PSC						
Rhode Island PUC	yes					
South Carolina PSC	yes	3,736,782		7,473,564 5/	.77	12/31/80
South Dakota PUC						
Tennessee PSC	yes			21,057,476	1.08	12/31/80
Texas PUC	yes	77,026,680	6,436,460	155,353,158	1.97	12/31/80
Utah PSC						
Vermont PSB						
Virgin Islands PSC	no					
Virginia SCC	yes	10,125,000		19,463,000 5/	1.00	8/31/81
Washington UTC	yes	18,855,000	3,653,000	43,638,000	2.06	12/31/80
West Virginia PSC						
Wisconsin PSC	yes	11,200,000	5,200,000	37,500,000	1.56	12/31/80
Wyoming PSC	yes	1,013,000		1,013,000 5/	.47	12/31/80

1. Anchorage Telephone Utility (municipal) represents at least 50% of all gross revenues.
2. Applies only to Mountain Bell intrastate.
3. Figures derived from rate cases of Southwestern Bell Telephone Co. and United Telephone Company of Kansas which supplies approximately 20% of independent main stations.
4. However, New Mexico SCC is seeking constitutional amendment to permit consideration of directory advertising revenue for ratemaking purposes. The net revenue derived from directory advertising by Mountain Bell is $7,029,000, and the net revenue derived from such advertising by the three largest independents (Continental, General Tel. of S.W. and Navaho) is $791,718.
5. Bell System only.
6. General Telephone of California only.

Mr. WIRTH. Thank you very much, Mr. Burke.
Mr. Schneidewind.

STATEMENT OF ERIC J. SCHNEIDEWIND

Mr. SCHNEIDEWIND. Thank you, Mr. Chairman. The prospect of extremely large rate increases, at least in our estimate, a literally doubling, if not tripling of rate increases, which would be caused by the proposed settlement of the A.T. & T. antitrust case has lent a sense of urgency to our appearance before you today, because without legislation which will deal with the details of telecommunications deregulation, we are fearful that the A.T. & T. settlement will become effective and cause, in our view, catastrophic increases.

I have with me the entire Michigan Public Service Commission, all three members, Commissioner Edwina Anderson, Commissioner Matt McLogan, because it is our view that the developments taking place today are of the utmost gravity to the citizens of our State.

In addition, I bring to you greetings on behalf of the Governor of Michigan, William G. Milliken, who asked me on his behalf to read the following statement.

> The House Subcommittee on Telecommunications, Consumer Protection and Finance is considering legislation and an antitrust settlement agreement which will completely change the telecommunications industry.
>
> Senate Bill 898 and H.R. 5158, as well as the proposed A.T. & T. settlement agreement, are intended to achieve competition in the provision of telephone equipment and long-distance services.
>
> I share the belief that competition in these areas may help to assure better telephone service at a lower cost than would be possible under the current system of regulation.
>
> While I believe that competition in the telecommunications field may offer long-range benefits, I am deeply concerned that both S. 898 and the proposed A.T. & T. antitrust settlement may result in substantial short-term cost increases for the Michigan citizens who can least afford them.
>
> It is too soon to assess the impact of H.R. 5158; however, I believe that both the A.T. & T. settlement agreement and S. 898, in conjunction with pending actions of the Federal Communications Commission, could produce a doubling or even tripling of basic telephone service rates.
>
> This basic telephone service is a necessity for many Michigan citizens who must have the ability to communicate rapidly for health services, fire protection and police protection.
>
> Many of our senior citizens and unemployed citizens could face increases in their telephone costs of over $150 a year. At such rates, these citizens might have to drop telephone service and lose their link with vitally needed services.
>
> I urge the members of the House Subcommittee on Telecommunications, Consumer Protection and Finance to use every means at their disposal to work for a national regulatory framework which will produce competition and continue to assure basic telephone service at rates that can be afforded by all citizens.

I also bring to you the perspective of a State official. I think that perspective has been honed, if anything, by the fact that I and my fellow commissioners have traveled through our State on a series of seven hearings, from the tip of the Upper Peninsula in Michigan down to the southeastern portion in Detroit.

In these hearings, we explained to the citizens of Michigan the potential impact of both the Senate legislation that is pending and the proposed A.T. & T. antitrust settlement.

Let me summarize our assessment of that impact for you. We believe that, in conjunction with recent FCC actions, the Senate bill could cause rate increases of at least 129 percent in the basic service costs to Michigan Bell customers.

We estimate that the Department of Justice settlement, at the very least, would cause increases for those Bell customers of 98 percent, but we are not able to put cost estimates on such impacts as the certainty that financing charges for local spun-off entities would drastically increase.

In view of these uncertainties, it is our assessment that the cost impact of the proposed settlement would far exceed that of the Senate bill.

Obviously, we also have said that, pending a more complete evaluation, it is our assessment that the proposed House legislation would cause a far less impact.

In the course of these seven hearings, we have found that the citizens of Michigan do feel that competition, if it is carefully structured, could bring to them the benefits of improved availability of equipment and potentially lower charges for certain services.

But there is also the concern among these people that service be affordable. They do not think that the pending Senate legislation and settlement agreement would produce affordable service.

Finally, it is the concern of these citizens that there be somebody, and I stress in our rural areas, which are often swept by snowstorms and which were swept by snowstorms while we were conducting these hearings, people are often locked into their homes for up to a week at a time, and often need vital medical services which can only be summoned by phone.

Our people in rural areas are extremely concerned that there be some entity which can be required to provide a basic telephone and service on that basic telephone, even if local economic conditions would not warrant the location of permanent maintenance forces.

In view of these needs, I have proposed and will propose to this committee six suggestions which we think could result in a competitive telecommunications market, and yet provision of basic service at affordable rates.

These six suggestions are as follows: No. 1, State regulators must be permitted to require an exchange carrier to provide basic telephone equipment and service on that equipment if unregulated entities are not providing such service or equipment.

Two, the yellow pages operation and the revenues from that operation must be retained by exchange carriers.

Three, State regulators must be permitted to decide the disposition of embedded customer premises equipment and station connections.

Four, State regulators must be assured that any assets transferred from exchange carriers to a deregulated entity or to A.T. & T. will be priced at fair market value.

Five, State regulators must be permitted to set access charges for exchange carriers. Or in the alternative, an administratively final joint board with majority State membership may set access charges.

But in either case, revenues received from access charges must at the outset equal revenues currently received from the separations and settlements process.

In the longer term, market forces and the ability of carriers to bypass the local network may force adjustments in access charges. However, a transition to this situation is paramount if universal service is to be continued and if the telephone network as it presently exists is to be able to survive.

Six, regulators must be allowed authority to set depreciation rates and methodologies for assets that they continue to regulate. Competitive market forces should be considered.

But as long as certain services continue to be regulated because of lack of competition or dominance of a carrier in the provision of that service, regulators must be given the authority to determine the acceptability of this significant portion of a carrier's operating costs.

These six criteria would enable State regulators to assure reliable basic service to all customers and to assure that that service is provided at a reasonable price.

If we take the six criteria detailed above, the chart set forth below makes it apparent that S. 898 meets none of these criteria, the proposed A.T. & T. settlement clearly meets only one of these criteria, but H.R. 5158 may meet several of the criteria.

I would urge this committee to help us provide affordable, reliable basic service to the citizens of our State, and in so doing, to act quickly so that the settlement agreement that is now pending in the Federal courts will not take effect, for otherwise we feel that that affordable and reliable basic service is indeed in peril.

Thank You

[Mr. Schneidewind's prepared statement follows:]

TESTIMONY OF MICHIGAN PUBLIC SERVICE COMMISSION
CHAIRMAN, ERIC J. SCHNEIDEWIND
Before the
Subcommittee on Telecommunications,
Consumer Protection and Finance
February 2, 1982

Chairman Wirth and members of the Subcommittee on Telecommunications, Consumer Protection and Finance, I am grateful for the chance to testify before this Committee regarding H.R. 5158 and the proposed settlement of the antitrust suit against AT&T.

I also bring you greetings on behalf of the Governor of Michigan, William G. Milliken. Governor Milliken is deeply concerned that many of the citizens of Michigan may be priced out of the telecommunications market if S. 898 or the proposed AT&T antitrust settlement are adopted in their current form. In order to acquaint you with his views, Governor Milliken asked me to include his personal statement in my formal testimony.

STATEMENT OF GOVERNOR WILLIAM G. MILLIKEN
Before the
Subcommittee on Telecommunications,
Consumer Protection and Finance

The House Subcommittee on Telecommunications, Consumer Protection and Finance is considering legislation and an antitrust settlement agreement which will completely change the telecommunications industry.

Senate Bill 898 and H.R. 5158, as well as the proposed AT&T settlement agreement, are intended to achieve competition in the provision of telephone equipment and long distance services. I share the belief that competition in these areas may help to assure better telephone service at a lower cost than would be possible under the current system of regulation.

While I believe that competition in the telecommunications field may offer long-range benefits, I am deeply concerned that both S. 898 and the proposed AT&T antitrust settlement may result in substantial short-term cost increases for the Michigan citizens who can least afford them.

It is too soon to assess the impact of H.R. 5158; however, I believe that both the AT&T settlement agreement and S. 898, in conjunction with pending actions of the Federal Communications Commission, could produce a doubling or even tripling of basic telephone service rates. This basic telephone service is a necessity for many Michigan citizens who must have the ability to communicate rapidly for health services, fire protection and police protection. Many of our senior citizens and unemployed citizens could face increases in their telephone costs of over $150 a year. At such rates, these citizens might have to drop telephone service and lose their link with vitally needed services.

I urge the members of the House Subcommittee on Telecommunications, Consumer Protection and Finance to use every means at their disposal to work for a national regulatory framework which will produce competition and continue to assure basic telephone service at rates that can be afforded by all citizens.

* * * * *

I hope to bring to your Committee the concerns and perspective of a state official who will have to explain to the consuming public the reasons for telecommunications deregulation and any adverse impacts that such deregulation may cause to these consumers. For, after all, state public utility commissioners are the ones who are going to have to make the regulated network technically compatible with the new deregulated telecommunications system on the local level and respond to customer complaints. State regulators will have to grant rate increases caused by deregulation and state regulators will have to assure the citizens of our states that they will continue to receive telecommunications services that are both reliable and affordable.

The perspective that I bring to these hearings may, in fact, be unique even for a state regulator because the Michigan Public Service Commission has just completed a series of 7 hearings throughout our state which afforded the citizens of Michigan an opportunity to learn about the impact of both S. 898 and the proposed settlement of the antitrust suit against AT&T. These hearings extended over the period of January 11 through January 28 and took the Michigan Public Service Commission from the tip of the Upper Peninsula in Houghton, Michigan down to the Detroit Metropolitan Area. At these hearings, Michigan Public Service Commission staff explained the potential impact of S. 898 and the antitrust settlement on the availability and price of basic telephone service.

I have included in my remarks below, a chart which breaks down in detail the cost impact information which was presented at these hearings. It should be borne in mind that in regard to S. 898 the cost impact information includes recent actions of the FCC. These cost estimates do not include the impact of inflation. Time did not permit a similar evaluation to be made concerning the potential impact of H.R. 5158. However, it is my preliminary evaluation that H.R. 5158 will cause far less adverse impact on basic telephone service costs than either the AT&T settlement or S. 898.

ESTIMATED EFFECTS OF S. 898 IN CONJUNCTION WITH PENDING FCC ACTIONS AND AT&T ANTITRUST SETTLEMENT ON MICHIGAN BELL TELEPHONE COMPANY RESIDENTIAL LOCAL SERVICE RATES PER MAIN STATION PER MONTH

	S. 898 with FCC Actions	AT&T Settlement
1. Depreciation Issues		
a. Rates Comparable to Competitors	$ 2.93	N.A.
b. Accelerated Depreciation on New Plant Additions	.40	
2. Change Separations Procedures and Deregulate Embedded Customer Premises Equipment		
a. Loss in intrastate toll revenue	1.86	$ 1.86
b. Loss in interstate toll revenue	2.53	2.53
3. Yellow Pages Revenue	2.10	2.10
4. Expense Station Connection Costs and Deregulate New Installations	1.47	1.47
5. Loss of Customer Premises Equipment Local Rates beyond the Separations Effect	1.27	1.27
Total estimated increase in local rates per main per month	12.56	9.23
Present monthly local service rate (residential)	9.74	9.74
Percentage increase in rates anticipated from implementation of S. 898 and FCC actions	129% *	98%**

*Does not include inflation.

**Does not include numerous other adverse cost implications which cannot be estimated at this time, such as increased BOC cost of capital, loss of EAS, BOC loss of interexchange, BOC losses due to transfer of assets to AT&T, etc.

Having completed our series of 7 hearings, it is safe to say that the citizens of Michigan have three overwhelming concerns regarding any proposed deregulation of the telecommunications system. One major concern is that they continue to be assured that someone or some company will provide them with a basic telephone and service on that telephone if no private entity wishes to serve their geographic area. This concern was expressed most frequently in rural areas, such as portions of the Upper Peninsula and Michigan's northern Lower Peninsula. The citizens of these areas know that a strict economic analysis would seldom, if ever, justify location of service personnel either permanently or temporarily in their area. Yet, it is obvious that citizens of sparsely populated rural areas are often most heavily dependent upon reliable and adequate telephone service. We completed several hearings in Michigan's Upper Peninsula at a time when severe snow storms had swept the area. Many of the secondary roads are often not cleared of snow for up to a week after a major storm. When natural disaster strikes, the telephone is often the only link people of this area have with essential health and safety services. There were many stories in the news regarding people who needed health services, such as birth of infants, who were only able to obtain this emergency medical service by using the telephone. Until now, regulated utilities have been required to install and service the basic telephone which enables the people of these regions to maintain their contact with the outside world. Both the Public Service Commissioners and the people of these regions are fearful that a deregulated terminal equipment market would not provide service to these areas because there is not enough business to warrant local maintenance forces.

A second, and equally serious, concern of all the citizens who attended our hearings was that telephone service must remain affordable to all segments of our population. Numerous senior citizens groups, unemployed workers (here it should be noted that Michigan has the highest unemployment level in the nation) and representatives of low-income groups indicated that they would not be able to afford telephone service at the doubled or tripled rates which were likely to result in the event of deregulation along the lines contemplated by S. 898 or the AT&T settlement agreement. These citizens emphasized that they were able to have telephone service currently because the existing rate structure made that service affordable to them. They also indicated that at doubled or tripled rate levels, telephone service would no longer be affordable to them. Senior citizens were particularly fearful that loss of telephone service would deprive them of the ability to quickly contact health or police protection services. Any loss in customers results in continued higher costs for the remaining customers.

Finally, and perhaps surprisingly, most of the citizens appearing at our hearings were in favor of competition in the telecommunications business if telecommunications service could continue to be available to all who required it and be available at an affordable price. The people of Michigan do have faith in the competitive system and believe that over a period of time a truly competitive environment could bring better service at lower prices, but they are also mindful of the impact of airline deregulation which has often left rural communities and many urban communities with very little, or very expensive, service.

In summary, I believe that the people of Michigan have enunciated four goals that they feel are minimum requirements of a new telecommunications regulatory framework:

1. Citizens must be assured that some entity will be required by law to sell and install at least basic telephone instruments and associated wiring in their home if unregulated entities do not provide that service.
2. Citizens must be assured that some regulated entity will be required to repair and maintain the telephone in their home if unregulated entities are not available to serve that need.

3. Basic telephone service must not be increased radically in price so as to make that service unaffordable to a large segment of the population.
4. Consistent with these goals, and to the extent competition exists, deregulation of certain telecommunications equipment and services may provide benefits in the form of better service at a lower price.

I believe that six principles, if adopted in the AT&T settlement or in any legislation passed by Congress, would secure competition in the telecommunications industry and assure basic telephone service at an affordable price. These six principles are as follows:

1. State regulators must be permitted to require an exchange carrier to provide basic telephone equipment and service on that equipment if unregulated entities are not providing such service or equipment.
2. The Yellow Pages operation and the revenues from that operation must be retained by exchange carriers.
3. State regulators must be permitted to decide the disposition of embedded customer premises equipment and station connections.
4. State regulators must be assured that any assets transferred from exchange carriers to a deregulated entity or to AT&T will be priced at fair market value.
5. State regulators must be permitted to set access charges for exchange carriers. In the alternative, an administratively final Joint Board with majority state membership may set access charges. In either case, revenues received from access charges must at the outset equal revenues currently received from the separations and settlements process. In the longer term,

market forces and the ability of carriers to bypass the local network may force adjustments in access charges. However, a transition to this situation is paramount if universal service is to be continued and if the telephone network as it presently exists is to be able to survive.

6. Regulators must be allowed authority to set depreciation rates and methodologies for assets that they continue to regulate. Competitive market forces should be considered. But as long as certain services continue to be regulated because of lack of competition or dominance of a carrier in the provision of that service, regulators must be given the authority to determine the acceptability of this significant portion of a carrier's operating costs.

These six criteria would enable state regulators to assure reliable basic service to all customers and to assure that that service is provided at a reasonable price.

If we take the six criteria detailed above, the chart set forth below makes it apparent that S. 898 meets none of these criteria, the proposed AT&T settlement clearly meets only one of these criteria, and H.R. 5158 may meet several of the criteria.

POSITION OF S. 898, H.R. 5158 and D.O.J. SETTLEMENT ON CRITERIA NECESSARY TO ASSURE RELIABLE AND AFFORDABLE BASIC TELEPHONE SERVICE

	S. 898	D.O.J. SETTLEMENT	H.R. 5158
1. Regulators able to require exchange carrier to service and supply basic equipment as a last resort.	No	No	Partly. Exchange carriers must provide CPE tariffed within 2 years of enactment until fully depreciated and offer inside wiring for 5 years unless extended by the FCC.
2. Allow exchange carriers to keep Yellow Pages.	No	No	No
3. State regulators decide how to dispose of embedded CPE.	No	?	Yes
4. Exchange carriers receive fair market value for assets transferred to AT&T.	No	?	Yes
5. State regulators empowered to set access charges and exchange carriers receive revenue equivalent to current separations and settlement process.	No	?	No. FCC empowered to assess surcharges on access charges for a National Telecommunications Fund which would be allocated to local service, but not necessarily at current levels of funding.
6. Regulators empowered to set depreciation rates and methodologies for assets of carriers utilized to provide regulated services.	No	Yes	Section not written.

From the standpoint of a state regulator, it is clear that H.R. 5158 comes closer than S. 898 or the proposed AT&T settlement to meeting the criteria that I believe are necessary to ensure reliable and reasonably priced basic telephone service in a competitive environment. Yet, I would be remiss in my duty to the citizens of Michigan if I did not indicate that H.R. 5158 must be amended if we are to assure that basic telephone service will be available to all at a reasonable price. I urge that H.R. 5158 contain specific provisions to assure that state regulators will be able to set depreciation rates for the assets of the carriers which they continue to regulate. I urge that H.R. 5158 allow exchange carriers to keep Yellow Pages. I urge that H.R. 5158 also be amended to specifically enable state regulators to set the charges for access to the local exchange or that exchange carriers be guaranteed revenues equal to those provided by current separation and settlement procedures. And, finally, I urge that H.R. 5158 be amended to provide state regulators with the ability to order regulated carriers to provide basic residential telephone equipment and service on that equipment if market forces do not act to provide an area with service or sales of basic residential telephone equipment.

With these four amendments, H.R. 5158 would provide state regulators with the tools they need to assure that each of the citizens of their state have access to basic telephone service which is reliable, reasonably priced and provided in a competitive environment.

Mr. **Wirth**. Thank you very much, Mr. Schneidewind.

Mr. Bryson.

STATEMENT OF JOHN E. BRYSON

Mr. **Bryson**. Thank you, Mr. Chairman. We in the United States have a unique kind of telephone system. It has been largely shaped by the policy of universal telephone service which was set out as the principal goal of existing communications legislation, the 1934 Communications Act.

As a result of that policy of universal telephone service, the quality of the phone system for Americans has been enhanced for all telephone users.

On behalf of the California Public Utilities Commission, I am here to warn you that unless great care is taken, many Americans will soon be unable to afford telephone service, degrading the quality of the telecommunications system for everyone.

Two years ago in California, we warned that a prior telecommunications reform bill, H.R. 6121, would cause basic monthly rates—the cost of just having a telephone—to be at least $20 per month higher within the decade under a cost allocation formula proposed in that bill. That was 2 years ago.

Last year we warned that if S. 898, the Senate telecommunications bill, were enacted, basic telephone rates in California would be likely to triple by 1985. We have sought, in warning Californians of these basic phone rate increases, to convey some sense of the extent to which basic phone rate increases, would be likely to remove many people from the telephone system altogether.

I want to call your attention this morning to the document that Congressman Scheuer, in my judgment, very accurately picked out in his opening remarks as a critical document.

We have asked that that document be distributed to the committee. It is a document prepared——

Mr. **Wirth**. Without objection, that will be included in the record.

Mr. **Bryson**. Thank you. This is a document prepared by A.T. & T. as an exhibit in its antitrust case. It sets out in a variety of categories the likely loss in telephone service that would follow certain basic phone rate increases.

Congressman Scheuer went through that well. I simply want to point out that a mere doubling in basic phone rates, and a doubling is significantly below most of the projections that have been made, but a doubling alone would result in a loss of phone service by 9 percent of all existing customers. That is, roughly 9 million households.

A tripling, which we predicted for California, would result in a loss by 25 percent of phone service to existing customers.

H.R. 5158 is, in our judgment, a far better bill than S. 898. Its provisions evidence a greater sensitivity to the need to protect the affordability of basic telephone than was evident in S. 898 or in earlier legislation.

Today, however, in the wake of the antitrust settlement between the Department of Justice and A.T. & T., your task has, in our judgment, become even more important. The broad terms of that proposed settlement offer grounds for hope that truly competitive markets may emerge, but they also could result in severely weakened local exchange carriers, sharply exacerbating the trend toward higher local phone rates.

Some of the widespread discussion of the proposed settlement has conveyed an impression that the basic questions relating to the future of telephone service in America have now been answered.

This is not true. Many exceedingly important questions remain, questions which this subcommittee and Congress not only should, but must, answer if universal telephone service is to survive in the 1980's.

A primary goal of your efforts should be to assure that adequate, reliable basic telephone service remains available to all Americans at reasonable rates.

In the context determined by the proposed antitrust settlement, there are at least six essential prerequisites to the achievement of this goal:

One, and I want to stress this strongly, and I will return briefly to it, the Bell operating companies must be divested from A.T. & T. intact, before any assets are transferred to A.T. & T. corporate affiliates, in order to assure that the Bell operating companies are fully compensated for the loss of valuable lines of business;

Two, the mechanism for setting fees for access to the exchange network must assure that such fees will be adequate;

Three, the operations of the Bell operating companies must be defined broadly enough to maintain local calling patterns that match communities of interest, and to allow the continuation of profitable lines of business related to exchange service, such as classified directory advertising.

Four, State commissions must be assured of adequate regulatory authority and flexibility to perform their tasks effectively;

Five, the Bell operating companies must be made truly independent of their former corporate parent, A.T. & T.; and

Six, presently regulated services and products should not be deregulated until effective and enduring competition is assured for the protection of consumers. [This concern applies to interexchange service as well as to elements of local service.]

The economic health of the local operating company is absolutely critical to the maintenance of affordable telephone service. These companies already face significant handicaps in today's economy.

Local network telecommunications is both a labor- and capital-intensive business, very sensitive to the ravages of inflation. The efficiency of this segment of the telephone industry, moreover, has not benefited greatly from the technological advances which have so transformed interexchange telecommunications and the terminal equipment business in recent years.

In addition, the economic regulation to which local operating companies are subject is inherently difficult and troubled in times of inflation and economic uncertainty.

Against this background and in the context of the proposed antitrust settlement, the California Commission has one fundamental concern, which we see as likely to determine the future character of telecommunications services in America.

Our concern is: What role will the Bell operating companies play in the process of reorganizing the Bell System and reconstituting the telecommunications industry? The role of the Bell operating companies could be a vigorous one, actively defining a business for themselves of viable scope, supported by adequate financial strength.

Or it could be a passive role, drifting with the tides of others' decisions, following the policy choices of a corporate parent with different long-term interests.

We are convinced that the answer to this question will depend upon how soon and how effectively the Bell operating companies are separated and divested from their parent, A.T. & T. Only a prompt divestiture will enable the operating companies to demand adequate compensation for assets to be transferred to A.T. & T.

It will also allow them to support efforts to achieve adequate fees for access to the exchange network, and to defend their other major corporate interests—interests which in the long run should benefit the customers of the Bell operating companies.

I would like to develop that point just a bit further, if I might, Mr. Chairman.

In the case of a public utility which has accumulated its assets over many years under the protective umbrella of a regulated monopoly, there is a public interest in the maintenance of those public utility assets and in their continued use for purposes which serve the public welfare. In the formal terms of the law governing public utilities, those assets have been dedicated to public utility purposes.

The proposed antitrust settlement between the Department of Justice and A.T. & T. appears to contemplate a transfer of substantial assets—real property, equipment, trained employees, corporate good will, et cetera—from the local operating companies to A.T. & T.

It appears that A.T. & T. may not intend to provide fair compensation—or any compensation at all—to the Bell operating companies for the "dedicated" assets of which they would be deprived.

Fair compensation would be avoided by stripping the Bell operating companies of their assets while they are still under control of A.T. & T., before the vaguely described "spin-off * * * or other disposition" required by the modified antitrust consent decree.

In our judgment, Congress must not permit such a taking of public utility assets. The language of H.R. 5158 indicates that Congress does not intend to do so.

Further safeguards, however, are needed to assure that the proposed antitrust settlement is not implemented without fair and reasonable selection, valuation, and compensation for assets to be transferred from the Bell operating companies to A.T. & T.

By far the most valuable safeguard would be the active participation of the Bell operating companies themselves sitting at a bargaining table negotiating with A.T. & T. on questions of assets selection, valuation, and compensation.

As the receiving party, A.T. & T. will naturally seek the most desirable assets, the lowest possible valuation, and the least burdensome form of compensation.

While under the control of A.T. & T., the Bell operating companies are in no position to protest. It is therefore essential, and this is the most important single recommendation that we have to make, that Congress require that the Bell operating companies be divested from A.T. & T. intact, with all their current assets and that only thereafter negotiations on details of the transfer of assets be undertaken and completed.

A.T. & T. shareholders may be indifferent to how the large pie of assets composing the Bell System is divided up. Telephone users and the Congress cannot be indifferent; to the degree the Bell operating companies are inadequately compensated by A.T. & T. for the loss of assets, the difference will have to be made up through higher rates for basic telephone service.

This is why the Bell operating companies themselves, which know their own assets best, must be in the position to advocate their and their ratepayers' interest in a fair and objective selection and valuation of the assets to be transferred.

With that, Mr. Chairman, I will stop my opening remarks. I will be happy to get to the other remarks set out in the prepared statement in questions.

[Testimony resumes on p. 190.]

[Mr. Bryson's prepared statement and document referred to follow:]

TESTIMONY
OF
JOHN E. BRYSON
PRESIDENT OF THE
CALIFORNIA PUBLIC UTILITIES COMMISSION

Mr. Chairman and Members of the Subcommittee on Telecommunications, Consumer Protection, and Finance:

Thanks to the policy of universal telephone service adopted by Congress in the 1934 Communications Act, nearly all Americans today can afford telephone service in their homes. As a result, the value of the nation's telecommunications system has been enhanced for all telephone users.

On behalf of the California Public Utilities Commission, I am here to warn you today that unless great care is taken, many Americans will soon be unable to afford telephone service, degrading the quality of the telecommunication system for everyone.

Two years ago, we warned that a prior telecommunications reform bill, H.R. 6121, would cause basic monthly rates -- the cost of simply having a telephone -- to be at least $20 per month higher within the decade under a cost allocation formula proposed in that bill. Last year, we warned that if S. 898, the Senate telecommunications bill, were enacted, basic telephone rates in California could triple by 1985. These increases should be evaluated against the AT&T analysis submitted in the antitrust case, that even a doubling of basic rates would result in the loss of phone service by nine percent of all customers -- roughly nine million households.

H.R. 5158 is a far better bill than S. 898. Its provisions evidence a greater sensitivity to the need to protect the affordability of basic telephone than was evident in S. 898 or in earlier legislation.

Today, however, in the wake of the antitrust settlement between the Department of Justice and AT&T, your task has become even more crucial. The broad terms of that proposed settlement offer grounds for hope that truly competitive markets may emerge, but they also could result in severely weakened local exchange carriers, sharply exacerbating the trend toward higher local phone rates that is already underway.

Some of the widespread discussion of the proposed settlement has conveyed an impression that the basic questions relating to the future of telephone service in America have now been answered. This is not true. Many exceedingly important questions remain, questions which this Subcommittee and Congress not only should, but must, answer if universal telephone service is to survive in the 1980's.

A primary goal of your efforts should be to assure that adequate, reliable basic telephone service remains available to all Americans at reasonable rates. In the context determined by the proposed antitrust settlement, there are at least six essential prerequisites to the achievement of this goal:

(1) The BOCs must be divested from AT&T intact, before any assets are transferred to AT&T corporate affiliates, in order to assure that the BOCs are fully compensated for the loss of valuable lines of business;

(2) The mechanism for setting fees for access to the exchange network must assure that such fees will be adequate;

(3) The operations of the BOCs must be defined broadly enough to maintain local calling patterns that match communities of interest, and to allow the continuation of profitable lines of business related to exchange service, such as classified directory advertising.

(4) State commissions must be assured of adequate regulatory authority and flexibility to perform their tasks effectively;

(5) The BOCs must be made truly independent of their former corporate parent, AT&T; and

(6) Presently regulated services and products should not be deregulated until effective and enduring competition is assured for the protection of consumers. (This concern applies to interexchange service as well as to elements of local service.)

The vision of a competitive market for new telecommunications products and services, incorporating the full range of electronic and computer technology, is an attractive one. However, it would be tragic indeed if the introduction of competition and new technology were to deprive a large number of our citizens of the basic telephone service they have come to expect. The loss of universal service would harm more than just those who must themselves give up their telephone service. Others must simultaneously give up the possibility of contacting the lost customer. This universality of service is different from the norm in many other countries, where a far lower percentage of households have phone service and where queues at the neighborhood pay phone are a serious nuisance of everyday life.

The economic health of the local operating company is absolutely critical to the maintenance of affordable telephone service. These companies already face significant handicaps in today's economy. Local network telecommunications is both a labor and capital intensive business, very sensitive to the ravages of inflation. The efficiency of this segment of the telephone industry, moreover, has not benefitted greatly from the technological advances which have so transformed interexchange telecommunications and the terminal equipment business in recent years. In addition, the economic regulation to which local operating companies are subject is inherently difficult and troubled in times of inflation and econmic uncertainty.

Against this background and in the context of the proposed antitrust settlement, the California Commission has one fundamental concern, which we see as likely to determine the future character of telecommunications services in America. Our concern is: What role will the BOCs play in the process of reorganizing the Bell System and reconstituting the telecommunications industry? The role of the BOCs could be a vigorous one, actively defining a business for themselves of viable scope, supported by adequate financial strength. Or it could be a passive role, drifting with the tides of others' decisions, following the policy choices of a corporate parent with different long-term interests.

We are convinced that the answer to this question will depend upon how soon and how effectively the BOCs are separated and divested from their parent, AT&T. Only a prompt divestiture will enable the operating companies to demand adequate compensation for assests to be transferred to AT&T. It will also allow them to support efforts to achieve adequate fees for access to the exchange network, and to defend their other major corporate interests -- interests which in the long run should benefit the customers of the BOCs.

In the remainder of my testimony I shall seek to describe some ways in which H.R. 5158 can address the issues I have outlined above.

ASSETS TRANSFER

In the case of a public utility which has accumulated its assets over many years under the protective unbrella of a regulated monopoly, there is a public interest in the maintenance of those public utility assets and in their continued use for purposes which serve the public welfare. In the formal terms of the law governing public utilities, those assets have been dedicated to public utility purposes.

Timing of Divestiture

The proposed antitrust settlement between the Department of Justice and AT&T appears to contemplate a transfer of substantial assets -- real property, equipment, trained employees, corporate goodwill, etc. -- from the local operating companies to AT&T. It appears that AT&T may not intend to provide fair compensation -- or any compensation at all -- to the BOCs for the "dedicated" assets of which they would be deprived. Fair compensation would be avoided by stripping the BOCs of their assets while they are still under contol of AT&T, before the vaguely described "spin-off...or other disposition" required by the modified antitrust consent decree.

Congress must not permit such a taking of public utility assets. The language of H.R. 5158 indicates that Congress does not intend to do so. Drafted to apply to the creation of a separate subsidiary, the provisions of H.R. 5158 dealing with assets transfer are even more essential in the context of the more radical separation which divestiture will entail. However, further safeguards are needed to assure that the proposed antitrust settlement is not implemented without fair and reasonable selection, valuation, and compensation for assets to be transferred from the BOCs to AT&T.

By far the most valuable safeguard would be the active participation of the BOCs sitting at a bargaining table negotiating with AT&T on questions of assets selection, valuation, and compensation. As the receiving party AT&T will naturally seek the most desirable assets, the lowest possible valuation, and the least burdensome fomr of compensation. While under the total control and domination of AT&T, the BOCs are in no position to protest. It is therefore essential -- and this is the most important single recommendation of the California Commission -- that Congress require that the BOCs be divested from AT&T intact, with all their current assets, and that only thereafter negotiations on details of the transfer of assets from the BOCs to AT&T be undertaken and completed.

AT&T shareholders may be indifferent to how the large pie of assets composing the Bell System is divided up. Telephone users and the Congress cannot be indifferent; to the degree the BOCs are inadequately compensated by AT&T for the loss of assets, the difference will have to be made up through higher rates for basic telephone service. This is why the BOCs themselves, which know their own assets best, must be in the position to advocate their and their ratepayers' interest in a fair and objective selection and valuation of the assets to be transferred. Only after complete divestiture from AT&T will the BOCs feel both free and obliged to promote and protect their own corporate interests as distinguished from those of their former parent, AT&T.

Supervision of Assets Transfer

Section 273(f) of H.R. 5158 provides for a transitional joint board to determine the value of assets to be transferred to a separate subsidiary. In includes critically important guarantees that assets will be valued at the higher of their fair market or book values and that investments in training, research and advertising will be recognized in estimating the value of transferred assets and personnel. These are excellent provision, covering a major omission in S. 898.

While Section 273(f) was drafted prior to the proposed antitrust divestiture, it addresses a continuing need. Even if primary reliance for valuation of transferred assets is placed, as we believe it should be, on negotiations between the independent BOCs and AT&T, there is need for a governmental oversight body for final approval or recourse in the event of failure to agree. In our view, this role could best be played by the existing state commissions, because they already are familiar with the details of the BOCs under their jurisdiction. Even if many issues can be resolved by negotiation, assets valuation will be a monumental task, better conducted through 51 simultaneous state proceedings than through one enormously complex and detailed investigation by a newly contituted joint board, with an as yet unconstituted staff and with other pressing tasks to perform as well. A more appropriate and limited role for the joint board would be as an appellate body reviewing disputed assets valuations by the state commissions.

A necessary adjunct to the assets valuation function is the valuation of liabilities. It is probable that AT&T will seek to compensate its BOCs for transferred assets, if at all, by means other than simple cash payments. If, for example, AT&T proposes to take over portions of the BOCs' debt obligations, the state commissions and the joint board should be clearly authorized to determine the value of the assumption of those liabilities.

Terminal Equipment

A major category of assets which may be transferred from the BOCs consists of in-place terminal equipment, ranging from the familiar telephone handsets to complex PBXs and other business equipment. Because the market for terminal equipment is the most competitve aspect of telecommunications today, H.R. 5158 contemplates substantial deregulation of this market. New terminal equipment would henceforth be offered only through a separated subsidiary, and in-place equipment would eventually be sold or transferred free of charge to its current users or be sold at public auction. The proposed antitrust settlement, by contrast, contemplates a transfer of these assets to AT&T.

The California Public Utilities Commission strongly supports the general approach to the disposition of terminal equipment taken by H.R. 5158. Congress should provide clear authority to the states to order the sale of in-place terminal equipment to BOC cumstomers. There is no real incompatibility between offering in-place terminal equipment to its current users and the proposed antitrust settlement. The goal of the latter obviously is to remove the BOCs from the terminal equipment business, which the H.R. 5158 approach would accomplish as well. The only differences in end effect would be that the House bill would permit ratepayers to derive some benefit from the vast assets accrued under regulation and would limit AT&T's subsequent domination of the market for used terminal equipment. With a substantial portion of such equipment under the ownership of telephone customers, a resale market would be more likely to emerge relatively free of AT&T's domination.

The California Commission now has a proceeding underway investigating the options for sale of in-place terminal equipment. Our staff has proposed two alternative plans, both providing for sale of telephone handsets to current users at book value but differing primarily in whether leasing of such equipment would remain an available option. We hope to conclude this phase of,the proceeding soon,and will then move on to the more complex subject of business terminal equipment.

In light of our experience thus far, we offer a few suggestions for amendment of H.R. 5158's terminal equipment provisions. The requirements of Section 272 that customers receive ownership of fully depreciated terminal equipment without charge are unworkable

Under current practice, terminal equipment, like most categories of telecommunications plant, is depreciated on a class basis. New equipment is constantly being added to the class, as worn-out items are removed, so the class as a whole never reaches full depreciation. Under H.R.5158 new equipment will no longer be provided by the BOCs, so the class as a whole would eventually fully depreciate, but this would take many years. To depreciate each item of terminal equipment separately would be an extremely complex task of accounting, probably impossible due to the absence of records as to the dates of initial telephone installation.

A further concern we have about the provisions for disposition of terminal equipment is the very short time period allowed for the transition to full deregulation. Section 272 provides for five years' continued regulation of inside wiring, but only two years for terminal equipment. Our Commission's experience suggests that two years are not sufficient time for the states to undertake and implement well the options which H.R.5158 seeks to provide. A period of five years would be more appropriate, tracking with a proposal now before the current federal-state joint board for removal of this equipment from the separations process.

EXCHANGE ACCESS FEES

Like the proposed antitrust settlement and S.898, H.R.5158 relies on a system of exchange access fees to provide contributions from interexchange service toward the costs of exchange facilities. These access fees would replace the separation and settlements procedures which, until now, have helped to keep local telephone rates low. These access fees must be a crucial element of any strategy for maintaining Universal Telephone Service.

The Transition to Access Fees

We are pleased to see that one of the stated purposes of H.R.5158's system of access fees is "to ensure the continued universal availability of telecommunications services provided by exchange carriers at reasonable and affordable rates". (Section 233(a)(6).) We are pleased as well that a federal-state joint board would be given responsibility to oversee the transition to an access fees system, to determine the relative assignment to interexchange services of indirect costs of exchange facilities, and to administer the proposed National Telecommunications Fund. (Section 273(e).)

We are greatly concerned, however, that H.R.5158 does not assure that interexchange carriers' contributions will, in fact, provide adequate support for local exchange transmission facilities costs. The decisive role of approving access fees proposed by the exchange carriers would be given to the Federal Communications Commission. The FCC is an agency, distant and relatively inaccessible to the local ratepayer, which traditionally has had a national overview responsibility likely to be incompatible with a careful attention to local needs. Even more troubling, the provisions of H.R.5158 defining the elements of the access fee are premised on the hope -- in our view, a false hope -- of determining "the cost of the use ofexchange transmission facilities." (Section 233(c)(2).) This language mav have the unfortunate effect of limiting the joint board's and the FCC's assignment of shared costs to a subscriber line usage (SLU) formula. A legislative commitment to such an allocation formula, in the absence of evidence as to what increases in basic local rates will result, is unwarranted.

Legislating use of the SLU factor to allocate local costs for determining access fees would double local rates for many customers. Appendix A to this testimony is an estimate from a 1980 base of changes that would be required in Bell System local rates in each state due to a change to SLU for interstate toll only. A corresponding change for intrastate toll would cause increases probably averaging 50 percent additional to those shown for interstate on the table. In states with much intrastate toll, such as California, the additional amounts would exceed 100 percent. The increases shown would be added to the effects of inflation and higher capital costs that will continue to drive local rates higher in any event.

Due to different calling patterns, cost levels, and other factors, the pattern of increases is quite variable. For example, in Denver, Colorado, the effect just of interstate conversion to SLU is an increase of 113.5 percent,but Cleveland, Ohio shows only 28.6 percent.

In terms of dollars, an estimate provided by the Bell System in June 1981 showed that the combination of converting to SLU and removing terminal equipment would reduce interstate toll support of the local operation by $10 billion annually in 1986. Since nearly all this $10 billion would appear as local rate increases (roughly $100 per customer), the transition from separations to access changes merits very close attention by Congress.

We recognize that the proposed National Telecommunications Fund would include an account "to provide for an orderly transition... to the level of payment, based only upon costs, available to exchange carriers under the system of access fees..., for the purposes of avoiding substantial or undue increases in charges for exchange service...caused by such transition." (Section 234(d)(1).) However, we are troubled by the vagueness of the concepts of "orderly transition" and "undue increases". We are even more concerned by the imposition of a ceiling on the total level of payments from access fees plus the National Telecommunications Fund, a ceiling frozen at the January 1, 1982 level of separation and settlements payments. (Section 273(e)(4).) In the absence of knowledge as to the demands which rapidly expanding interexchange services will place upon local exchange facilities, it is arbitrary and inappropriate to impose such a ceiling -- particularly in the context of the proposed antitrust settlement's threat to the economic viability of the BOCs.

Congress should recognize its inability to forecast the appropriate level of support to be provided by interexchange services to the local network, and recognize as well the need to provide a clearer mandate to the joint board and the FCC. We recommend that the vague concept of "substantial or undue increases" in Section 234(d)(1) be replaced by an explicit limit of five percent per year as the maximum permissible rate of increase in charges for exchange service caused by the transition. Congress should expressly determine the degree to which the transition to competition is allowed to drive local phone rates up. Only such a clear standard will provide meaningful protection for the local telephone ratepayer, who will in any event be seriously burdened by rate increases due to inflation, capital costs, and other independent factors.

The Joint Board

Effective performance of the responsibilities which Section 273(a) assigns to the proposed joint board is absolutely critical to the maintenance of reasonable rates for local telephone service. We believe that a state majority on the joint board is needed to assure meaningful representation of local interests in the determination of exhange access fees. Furthermore, we see no justification for the joint board going out of existence after five years. (Section 273(i).) There is no prospect for access fees ceasing to be of critical importance after five years; nor is there any assurance that the "orderly transition" will be completed in so short a time. The joint board should be permanent.

SCOPE OF LOCAL EXCHANGE CARRIER OPERATIONS

The economic viability of the BOCs and the hope of ratepayers for maintenance of adequate, affordable local telephone service cannot be assured by proper assets valuation and access fees along. In addition, the operations fo the BOCs must be defined broadly enough to allow them to continue and develop profitable lines of business related to their essential exchange service functions. The BOCs will be seeking -- and needing -- means of augmenting current revenues. Sources of such revenues are available within the current operations of the BOCs, integrally related to their exchange transmission functions. Sound public policy dictates against depriving the exchange carriers of their benefits. The principal operations that should be retained in addition to basic exchange service, are discussed below.

Classified Directory Advertising

Most obvious among aspects of their business which should remain with the BOCs is the sale and provision of classified directory advertising, at least in its printed form. As I noted in my testimony last year on S. 898, directory advertising revenues are the product of local exchange telephone service and should be applied to keep basic rates affordable. Depriving Pacific Telephone Company, for example, just of this support, would require an increase in basic rates for its customers of more than $1.35 per month.

There is no persuasive reason to deprive the BOCs of this lucrative revenue source. Its transfer to AT&T makes no sense. The directory advertising business has no relation to the major fields of AT&T's future operations -- terminal equipment and interexchange services. To the contrary, classified directory advertising is an adjunct to the white pages listings which must necessarily remain part of exchange carrier operations.

The directory advertising business is today almost totally monopolized by the BOCs within their respective service areas. For many types of businesses -- especially small businesses -- neither advertisers nor their potential customers have any real alternative to the yellow pages. The lack of competition is made clear by the fact that profits from directory advertising ($167 million for Pacific Telephone Company in 1981) comprise well over half of gross directory revenues. Allowing these profits to restrain increases in BOC revenue needs would be far less anticompetitive than shifting them to AT&T to underwrite that company's continued domination of potentially competitive terminal equipment and interexchange markets.

In the not too distant future electronic advertising directories may offer the potential for genuine competition, but that day has yet to come. As it does, retention of the printed directory business by the

BOCs could tend to equalize the competitive position of AT&T and its potential rivals -- and the BOCs' printed directories will enhance the advertiser's and the consumer's range of choice among information media. In the meantime the monopoly profits from directory advertising should benefit the customers of the regulated exchange carrier.

H.R.5158 appears to contemplate a different result, excluding the dominant carrier entirely from electronic classified advertising but permitting it to conduct its printed directory advertising business through a deregulated separate subsidiary. (Section 263(d), (e).) Another provision of the bill, Section 211(b), expressly forbids regulatory authorities to recognize revenues of affiliates from unregulated services in determining the revenue requirements of regulated carriers. This would appear to deprive BOC ratepayers of the benefit of classified advertising profits.

With the proposed antitrust settlement the current providers of printed yellow pages, the BOCs, can be separated from the purveyor of electronic advertising, thereby avoiding anticompetitive impacts while devoting current monopoly profits to the maintenance of reasonable basic rates. This can be achieved by providing in H.R. 5158 that the printed classified directory advertising business shall constitute an aspect of exchange telecommunications.

Definition of Exchange Areas

A second major means of broadening the scope of exchange carrier operations is by allowing for relatively expansive local exchange areas. This can provide two benefits, allowing a broader revenue base for the BOC while also recognizing realistic calling areas conforming to local communities of interest.

H.R.5158 improves on prior legislation and is clearly preferable to the proposed antitrust settlement in its approach to the definition of exchange areas. Leaving the determination of exchange areas to the state commissions, subject to review by the joint board, is appropriate, as is the criterion of common social and economic purposes. (Section 231(b), (c)(1).)

Continued reliance on the standard metropolitan statistical areas (SMSA) as a limiting criterion causes serious problems for regions with contiguous SMSAs, such as Southern California and the San Francisco Bay Area, but the provision for appropriate exceptions by the joint board may obviate this difficulty. (Section 231(c)(2).) We hope that suitable report language will make clear that California is a "densely populated state" entitled to such exceptions and that overlapping exchange areas will be permitted, to avoid the dilemma of excluding boundary residents from the exchange areas of half their neighbors. There is no sense in requiring exchange carrier customers to go to the FCC to complain about rates for essentially local calls. Further, as an alternative to the SMSA criterion, H.R. 5158 should permit definition of an exchange area in terms of a Consolidated Statistical Area, as defined by the Department of Commerce.

Over many years of regulation in a context of growing metropolitan areas, the California Commission has adopted a variety of extended area services to provide pricing schemes suited to the local calling patterns and communities of interest of particular geographical areas. Often such calling patterns link shopping or employment centers with outlying residential communities, crossing one or more exchange boundaries, and extending between eight and 40 miles. These arrangements may be mandatory for all residents of two or more closely linked communities, or they may be optional. In both cases the recipients of the extended services must pay higher charges on either a monthly or a usage-timed basis but the result is a lower overall bill.

We believe it would be unnecessarily disruptive and wasteful of many years' accumulated experience were such extended area services to fall victim to the limitation of the BOCs to exchange service. Consequently, we propose that a provision be added to Section 231 of H.R. 5156 declaring that any extended local calling, zone calling, or optional calling arrangement established as of January 1, 1982, shall be considered exchange transmission service within the meaning of that Section and under the exclusive jurisdiction of the appropriate state commission. In addition, we suggest that the states be empowered to establish exchange transmission service to provide new extended local calling, zone calling, or optional calling arrangements where such transmissions do not exceed distances of 50 miles. This would be an alternative to the creation of overlapping exchange areas and would be a simpler, more satisfactory approach in many cases. Establishment of new extended area services could be made subject to guidelines to be set by the joint board.

Enhanced Services

Another field in which the BOCs should be permitted to broaden their base of operations is that of certain enhanced services uniquely suited to provision through the exchange network. Prime examples are call forwarding, call waiting, and "custom calling" answering services. These are all products of ratepayer-funded Bell System research and development; all have existing or potential markets; and all represent technological alternatives which may have to be abandoned if it is forbidden to offer enhanced services through the local network.

There is little risk that the BOCs will cross-subsidize such potentially lucrative services at the expense of their regulated exchange operations. Pressures in the opposite direction -- to restrain increases in basic rates -- will be too great, and state regulatory commissions can be expected to closely supervise cost allocations within the BOCs to assure that basic ratepayers are bearing no more costs than absolutely necessary, let alone subsidizing competitive service offerings. Moreover, entry of the BOCs into a limited sector of enhanced services would benefit competition by presenting additional rivals for pieces of these markets which are threatened with domination by AT&T. Such rivalry should aid in establishing the autonomy and diversity of the BOCs vis à vis their former parent corporation. Consequently, we recommend that Section 228 of H.R.5156 be amended to provide expressly that exchange carriers may offer enhanced services integrally related to their exchange facilities.

SCOPE AND FLEXIBILITY OF STATE REGULATION

The reorganization of the telecommunications industry dictated by the proposed antitrust settlement and prospective legislation, while seeking to promote competition, will severely restrict the scope of regulation by state commissions. At the same time the need and demand for state commissions to protect ratepayers from drastic increases in basic telephone rates will become greater than ever before. It is therefore essential that whatever legislation is enacted leave state authorities as much regulatory freedom and flexibility as is consistent with the goal of enhanced competition and orderly transition to deregulation of competitive markets.

I have already referred to a number of areas in which the ability of state regulators to act in the ratepayers' interest requires protection and enhancement. One is the need for the state commissions to have a direct role in the valuation of assets to be transferred to AT&T; a second is the opportunity to arrange a sale of terminal equipment to customers or at auction; others are the need for crediting directory advertising revenues to regulated operations and for flexibility in defining exchange areas.

There are further threats, of an even more basic nature, to the ability of state regulators to perform what will become their key role -- ensuring the reasonableness of local exchange rates. These include the imposition of unnecessary constraints on regulators' ability to include considerations of fairness and equity in the ratemaking process, possible abdication to the utilities of the selection of methods of depreciation to be used in ratemaking, and a considerable narrowing of regulators' ability to audit transactions involving utilities under their jurisdiction.

Equity in Ratemaking

A recurrent theme in H.R.5156 is that cross-subsidization of one service by another can be used for anticompetitive purposes and therefore should be prohibited. The California Commission supports this position with respect to the subsidization of competitive or potentially competitive service offerings. We are concerned, however, that some references to this subject in H.R.5156 are so broad as to apply also to the design of rates for noncompetitive intra-exchange services. For example, Section 223(b)(1) provides that the charge for any component or segment of regulated service must include all costs associated with such component or segment and must not result in increased charges for any other regulated service.

For each component or segment of service to carry its own weight sounds fine in theory, but it would be unmanageable and inequitable in practice. It would be unmanageable because it would require exchange carriers and their state regulators to examine and set rates for every distinguishable element of service on an independent basis. In the extreme it would require a separately calculated rate for each customer.

Today telephone rates for any given utility are relatively uniform and simple, by virtue of the averaging of costs for a variety of service segments. If interpreted as it reads, Section 223(b)(1) would require a myriad of different rates for calls of equal length along different routes. This would also be an unfair result, because the differences in costs of calls upon routes of equal length are often the result of accidents in geography or in the vintage of telephone equipment. We suggest that there is no need for Section 223(b)(1) to apply to intra-exchange services. If it must, we propose that language be added making clear that the provision does not prohibit rate averaging and that the phrase "component or segment of service" should be interpreted to refer to broad categories of service only, at least in the intra-exchange context.

Depreciation Methods

Prior proposed telecommunications legislation has included provisions which would have allowed regulated utilities to select and, without the consent of their regulators, adopt any form of accelerated depreciation for ratemaking purposes. H.R.5158 presently is silent on the subject of depreciation; we believe it should stay that way.

Section 220(b) of the Communications Act of 1934 empowers the the FCC to establish and modify: (1) classes of property for which depreciation charges may be included as operating expenses, and

(2) the percentage rates of depreciation to be charged. Such authority is an essential element of public utility rate regulation.

Allowing a common carrier with market dominance to select any form of depreciation it prefers would give it substantial power to establish a major component of its own rates and would usurp regulation's role as a substitute for competition. For so long as market dominance persists, the ultimate decision on whether to employ straight line or some form of accelerated depreciation for ratemaking purposes (as distinguished from tax purposes) should be left to regulatory bodies so that they may establish a proper balance of impacts on ratepayers and utility cash flow.

In recent years there has been much criticism of the slow rates of depreciation enforced by regulators for much telecommunications plant. This practice has been seen as detrimental to telephone utilities' cash flow and to their ability to meet competition in terminal equipment and other markets. The practice of regulators, however, is rapidly changing, both at FCC and state levels. As a competitive future for the telecommunications industry becomes clear, regulators are increasing rates of depreciation. The recent FCC action substantially increasing depreciation rates for AT&T long lines plant is a case in point, as have been the last several years' rate decisions of the California Commission, which have increased the average overall depreciation rate for Pacific Telephone Company from 5.3 percent in 1975 to 6.0 percent in 1981, and for General Telephone of California from 5.1 to 8.2 percent during the same period. Regulators also have been exploring other methods for clearing out utility investments in older plant, such as the sale of terminal equipment to customers. Yet the need for regulatory oversight of this important element of telephone service pricing remains. No change in Section 220(b) of the Communications Act is required.

Auditing Capability

In the context of creation of one or more separate subsidiaries within the Bell System to conduct competitive businesses, with a consequent need to prevent cross-subsidies of competitive operations, auditing of the books of account of both the regulated and the competitive corporate affiliates is an essential regulatory tool. If the BOCs are to be truly divested from AT&T and to develop their own corporate identity and self-interest, then regulatory auditing of transactions between the BOCs and AT&T affiliates may become less important. However, it is far from certain that the proposed antitrust settlement will result in really autonomous local operating companies, at least in the near term. It is therefore important that authority be granted to the FCC and state regulators to permit them to examine the books of AT&T and its affiliates with respect to transactions with the BOCs, at least for a specified transition period.

CORPORATE REORGANIZATION

The complex provisions of H.R.5158 dealing with the creation of separate subsidiaries and with the procurement practices of the dominant carrier will need modification in view of the proposed antitrust settlement, unless Congress determines that legislation should entirely supersede the settlement. AT&T's acceptance of the principle of divestiture of its local operating companies provides both an opportunity and a challenge to your Subcommittee.

Relationships Among Bell Entities

The proposed antitrust settlement prescribes broadly that ownership of "portions of the BOCs" relating to exchange operations would be transferred from AT&T. The precise form which this partial divestiture takes and its relation to the transfer of BOC assets to AT&T may well have a decisive impact on the subsequent economic viability of the BOCs.

The proposed settlement does not make clear whether AT&T will retain portions of its stock ownership of the BOCs. To provide a clean break and a full separation between AT&T and the BOCs, H.R. 5158 should require full divestiture of all AT&T ownership of the capital stock of the BOCs, and should prohibit the appointment of common directors to the governing boards of AT&T and any BOC.

Market Domination by Western Electric

At the same time, AT&T's manufacturing subsidiary, Western Electric, will at least in the near term have a near monopoly in the supply of many essential items of equipment to the BOCs. A primary example is the largest category of equipment purchased by the BOCs, central office switches, of which Western supplied 90.5 percent of Bell System requirements as recently as 1978. (Majority Staff Report, at 183.) It is unlikely that any potential competitors anywhere in the world, let alone in the United States, presently have the productive capacity to challenge Western's dominance of their market.

We therefore suggest a pair of possible solutions, which may appear to run counter to the pro-competitive, deregulatory thrust of H.R. 5158, but which are actually consistent with that bill's recognition that there are circumstances "where market place forces cannot be relied upon". (Section 201(b)(1).) One approach would be to give the FCC transitional authority, for a period of five years to: (1) determine, upon the petition of any BOC or any state commission or upon its own motion, that effective competition does not exist for the provision of specific products to one or more BOC, (2) suspend any challenged change in the terms or conditions under which AT&T's manufacturing affiliate supplies such products to the BOC, and (3) order AT&T or its affiliate to show cause why such suspension should not be made permanent. Grounds for suspension would include pricing of noncompetitive products at levels which produce unreasonably high rates of return or any other unreasonable or anticompetive practice. A second alternative would be to establish an appropriate index to govern increases in the prices of products supplied by Western Electric to the BOCs during a five-year transition period.

LIMITS TO DEREGULATION

H.R. 5158 evidences a policy of fostering competition which will protect customers, rather than competition for its own sake. That policy is grounded on the view that deregulation should not occur until effective competition exists. A company with a dominant market share -- as the Bell System has in many markets -- can exploit this advantage by overpricing products to consumers unless regulation is retained. In addition, it is important to recognize that some of the telecommunications network is in fact a natural monopoly, in which competition is undesirable and unworkable, and for which the current regulatory system should be retained.

Customer Premises Equipment

H.R. 5158 recognizes the state of competition in the customer premises equipment (CPE) market. While competition has emerged in recent years in the provision of new terminal equipment, H.R. 5158 recognizes that the existing base of equipment is owned and leased by the Bell System, giving AT&T a dominant position in this market. "Flash cut" deregulation of terminal equipment, as proposed in the antitrust settlement, would give the Bell System an opportunity to overprice its equipment by exploiting its dominant market position. We support the general outlines of the alternative proposed by H.R. 5158, which would deregulate new equipment in the near future, but leave existing equipment under regulation for a longer period, giving states the opportunity to provide for the sale of terminal equipment to customers. A sale program would limit AT&T domination of this market, thus shortening the necessary transition period to full deregulation.

H.R. 5158 also addresses inside wiring, deregulating that service five years after enactment. Currently, competition in inside wiring is extremely limited, but we expect it will develop fairly quickly in the near future. Meanwhile, it is appropriate that operating companies continue to offer the service at a regulated price. H.R. 5158 handles this issue well.

The antitrust settlement is ambiguous as to whether inside wiring would be transferred to AT&T as part of customer premises equipment or whether it would remain a s part of the operating company. It is essential that it remain with the BOCs, because inside wiring is basically a local service that could not be delivered efficiently by a national marketing operation. Clarification of this point in H.R. 5158 would be helpful.

Interexchange Service

H.R. 5158 encourages competition in the interchange market and ultimate deregulation when substantial competition evolves. While we share the desire to cultivate competition where viable, it is not at all certain that a fully competitive structure will ever evolve in this market. Prudence requires anticipating the possibility that FCC cost-of-service regulation may be required indefinitely with respect to interexchange service.

For competition to be workable in interexchange markets, the interexchange technology must be such that economies of scale flatten out at some point to allow more than one carrier to operate profitably.

If economies of scale increase with usage (that is, if costs per call continually decline as more calls are made), then one dominant carrier can operate at lower cost and eventually drive out all competitors. Under this condition of "natural monopoly", artificially fostered competition would be inefficient and short-lived, and regulation would be necessary and appropriate to protect consumers from abuse by the dominant carrier.

We do not know whether under current or foreseeable technology interexchange service is a natural monopoly or not. Perhaps experimentation will prove that competition can flourish. However, given the advantages of multiple routing opportunities and the advent of highly efficient transmission technology such as fiber optics which can handle very high calling volume on one line, we may find that interexchange service exhibits natural monopoly characteristics and that competition will prove unworkable.

We do not want to discourage experimental competition in interexchange service. However, we recommend that your legislation give the FCC broad authority to maintain and reassert jurisdiction even after it has deregulated a segment, should the competition prove to be destructive. Otherwise, waste and fruitless litigation will be the only outcome as the FCC tries to fulfil a mandate of promoting competition in a market that turns out to be inherently a natural monopoly.

Also, we strongly oppose allowing AT&T to establish an unregulated subsidiary which could compete in the provision of interexchange service with the regulated AT&T Long Lines, as seems contemplated by

Section 253(b) of H.R. 5158. Such head-to-head competition within AT&T raises the spectre of cream-skimming by the unregulated affiliate at the expense of the regulated entity.

Intra-exchange Service

Intra-exchange service is a natural monopoly; one firm can more efficiently provide the service than several. In light of this, it is unclear why H.R. 5158 would require the promotion of competition in the intra-exchange market. Competition, when introduced in a market that is a natural monopoly can lead to waste and can complicate ratemaking substantially. If competitors undercut the regulated carrier in one market, other rates will be forced upward to cover costs. We recommend that intra-exchange service remain a monopoly franchise like other public utilities, and that the ambiguous exhortations in H.R. 5158 to promote intra-exchange competition be deleted.

Proposal for an Annual Survey on Universal Telephone Service

Universal telephone service was the preeminent policy goal in the 1934 Telecommunications Act, and is an avowed goal of all the telecommunications reform legislation proposed in recent years. To maintain universal telephone service, it is, of course, essential to keep basic telephone rates at affordable levels. It is also important that drastic rate increases not occur suddenly, adversely and unexpectedly affecting ratepayers.

Because of the importance of universal telephone service, we recommend that the FCC be required to undertake an annual survey to determine the percentage of residences that have telephones. We suggest that the FCC be directed, if the percentage falls significantly, to report to Congress with recommendations on how to arrest the decline. By requiring such a study, Congress woul focus continuing attention on this vital issue.

CONCLUSION

Thank you for having given me the opportunity to address you today on the very serious issues raised by H.R. 5158 and the proposed AT&T antitrust settlement. My fellow members of the California Commission, our staff, and I will be most happy to provide whatever further information or assistance might be of use to you and your Subcommittee. We are prepared to provide your staff with appropriate amending language for H.R. 5158 in line with the policy concerns which I have expressed today.

APPENDIX A

Effect of Per-Line Change in Interstate Separations on Individual Line Residence Rate in Largest Bell Exchange in Each State 3/

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Assumes elimination of weighted minutes of use (SPF factor)
under Ozark Plan with substitution of SLU factor and
elimination of terminal equipment and station connections
from the allocation of subscriber plant costs to interstate operations
Bell Company Exchanges, Year 1980 Basis

State and City	Monthly Ind. Line Residence Rate 1/ 7/1/80	Monthly Effect of Separation Change 2/ Year 1980	Rate adjusted for Separation Change	Percent Increase
Alabama, Birmingham	$13.50	$ 4.92	$18.42	36.4%
Arizona, Phoenix	9.50	9.50	19.00	100.0
Arkansas, Little Rock	9.95	5.92	15.87	59.5
California, Los Angeles	6.00	5.25	11.25	87.5
Colorado, Denver	8.00	9.08	17.08	113.5
Connecticut, Hartford	8.77	6.00	14.77	68.4
Delaware, Wilmington	7.95	6.08	14.03	76.5
District of Columbia, Washington	9.65	8.08	17.73	83.7
Florida, Miami	12.30	9.83	22.13	79.9
Georgia, Atlanta	11.85	6.66	18.51	56.2
Idaho, Boise	7.00	7.25	14.25	103.6
Illinois, Chicago	5.55*	4.83	10.38	87.0
Indiana, Indianapolis	11.25	4.08	15.33	36.3
Iowa, Des Moines	9.10	5.08	14.18	55.8
Kansas, Kansas City	7.35	5.58	12.93	75.9
Kentucky, Louisville	11.44	4.25	15.69	37.2
Louisiana, New Orleans	11.10	5.00	16.10	45.0
Maine, Portland	10.25	5.17	15.42	50.4
Maryland, Baltimore	9.42	3.83	13.25	40.7
Massachusetts, Boston	9.70	4.92	14.62	50.7
Michigan, Detroit	8.75	3.08	11.83	35.2
Minnesota, Minneapolis	9.50	5.25	14.75	55.2
Mississippi, Jackson	14.75	6.08	20.83	41.2
Missouri, St. Louis	8.50	5.00	13.50	58.8
Montana, Billings	5.75	8.00	13.75	139.1
Nebraska, Omaha	9.45	7.83	17.28	82.9
Nevada, Reno	8.35	18.92	27.27	226.6
New Hampshire, Manchester	10.90	8.00	18.90	73.4
New Jersey, Newark	7.65	5.42	13.07	70.8
New Mexico, Albuquerque	7.85	7.33	15.18	93.4
New York, New York City	6.04#	5.66	11.70	93.7
North Carolina, Charlotte	8.55	4.75	13.30	55.6
North Dakota, Fargo	9.65	7.33	16.98	75.9

* Measured Rate, includes 80 message units

# Measured Rate, includes message allowance of $4.00 usage

State and City	Monthly Ind. Line Residence Rate 7/1/80	Monthly Effect of Separation Change Year 1980	Rate adjusted for Separation Change	Percent Increase
Ohio, Cleveland	$11.95	$ 3.42	$15.37	28.6%
Oklahoma, Oklahoma City	6.20	6.17	12.37	99.5
Oregon, Portland	8.05	6.58	14.63	81.7
Pennsylvania, Philadelphia	6.65	3.17	9.82	47.7
Rhode Island, Providence	13.00	4.75	17.75	36.5
South Carolina, Columbia	9.80	4.75	14.55	48.5
South Dakota, Sioux Falls	7.75	7.33	15.08	94.6
Tennessee, Memphis	10.80	4.42	15.22	40.9
Texas, Houston	8.15	5.33	13.48	65.4
Utah, Salt Lake City	9.17	5.42	14.59	59.1
Vermont, Burlington	10.10	9.00	19.10	89.1
Virginia, Richmond	9.55	5.50	15.05	57.6
Washington, Seattle	8.25	5.58	13.83	67.6
West Virginia, Charleston	14.83	4.33	19.16	29.2
Wisconsin, Milwaukee	9.50	3.42	12.92	36.0
Wyoming, Casper	7.79	16.42	24.21	210.8

Notes: 1/ NARUC Exchange Service Telephone Rates in Effect June 30, 1980

2/ AT&T Reply to Information Request #2 to Joint Board in FCC CC Docket No. 80-286, average interstate revenue requirement removed from interstate, per main station.

3/ In practice, the revenue requirement resulting from a shift from interstate would probably be spread in proportion to the basic rate. Business rates would have a higher increase; rates in smaller exchanges would have a lesser increase. Because of the variation above and below the large city residential rate it is probable that these rates would pick up close to the average increase per line.

ESTIMATED PERCENTAGE OF HOUSEHOLDS WITH BASIC TELEPHONE SERVICE[1]

DEMOGRAPHIC CHARACTERISTICS[3]	PRICE INCREASE[2]			
	BASE	50%	100%	200%
ALL	91.52	88.15	83.69	70.92
YOUNG	85.39	80.12	73.54	56.92
BLACK	86.37	81.38	75.08	58.89
RURAL	88.84	84.59	79.10	64.28
MODERATELY POOR	83.81	78.12	71.11	53.93
YOUNG	72.18	64.14	55.22	36.97
BLACK	75.25	67.71	59.12	40.74
RURAL	79.26	72.48	64.50	46.34
VERY POOR	79.28	72.52	64.53	46.38
YOUNG	64.99	56.14	46.88	29.56
BLACK	69.21	60.78	51.66	33.69
RURAL	73.85	66.07	57.31	38.96

SOURCE: HOUSEHOLD DEMOGRAPHIC AND ECONOMIC DATA: U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, MONEY INCOME OF HOUSEHOLDS IN THE UNITED STATES: 1979 (WASHINGTON, D.C.: U.S. GOVERNMENT PRINTING OFFICE). U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, HOUSEHOLD AND FAMILY CHARACTERISTICS: MARCH 1980 (WASHINGTON, D.C.: U.S. GOVERNMENT PRINTING OFFICE).

TELEPHONE RATE INFORMATION: AMERICAN TELEPHONE AND TELEGRAPH COMPANY, MARKET AND SERVICE PLANS DEPARTMENT, RESEARCH SECTION, MARKET RESEARCH INFORMATION SYSTEMS (MRIS).

DEFENDANT'S
EXHIBIT
D-4-1518

[1] PERCENTAGES DERIVED FROM THE LOGISTIC EQUATION IN TABLE 3 OF ECONOMIC AND DEMOGRAPHIC DETERMINANTS OF RESIDENTIAL DEMAND FOR BASIC TELEPHONE SERVICE USING HOUSEHOLD DEMOGRAPHIC AND ECONOMIC DATA FROM THE FOLLOWING SOURCES: U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, MONEY INCOME OF HOUSEHOLDS IN THE UNITED STATES: 1979 (WASHINGTON, D.C.: U.S. GOVERNMENT PRINTING OFFICE), AND U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, HOUSEHOLD AND FAMILY CHARACTERISTICS: MARCH 1980 (WASHINGTON, D.C.: U.S. GOVERNMENT PRINTING OFFICE).

[2] THE CHARGES USED IN THIS TABLE ARE THE MINIMUM PRICE FOR BASIC SERVICE. THE BASE PRICE, $5.61, ASSUMES NO REAL PRICE INCREASE FROM 1970 THROUGH 1979. THE OTHER CASES REFLECT A 50%, A 100%, AND A 200% INCREASE RESPECTIVELY IN THE BASE PRICE.

[3] 1979 HOUSEHOLD DEMOGRAPHIC AND ECONOMIC DATA (IN 1970 CONSTANT DOLLARS):

VARIABLE	UNIT OF VARIABLE	VARIABLE MEAN
INCOME ADJUSTED MONTHLY SERVICE CHARGE	DOLLARS	5.61
INSTALLATION CHARGE	DOLLARS	7.34
MEASURED RATE SERVICE	INDICATOR	0.35
AGE OF HEAD	YEARS	46.51
INCOME	$100	104.98
AGE × INCOME	$100-YEARS	488.26
PERSONS PER HOUSEHOLD	NUMBER	2.75
EDUCATION	YEARS	11.73
URBAN	INDICATOR	0.86
BLACK	INDICATOR	0.11
SOUTH	INDICATOR	0.32
EMPLOYMENT	INDICATOR	0.69
OTHER MALE HEAD	INDICATOR	0.02
MALE INDIVIDUAL	INDICATOR	0.11
FEMALE INDIVIDUAL	INDICATOR	0.58

IN ORDER TO EVALUATE THE EFFECT OF PRICE ON SUBGROUPS, INDIVIDUAL VARIABLES WERE CHANGED. THE AGE OF HEAD OF HOUSEHOLD WAS SET EQUAL TO 25.00 TO ESTIMATE PERCENTAGES FOR THE SUBGROUP YOUNG. THE VARIABLE AGE × INCOME WAS SET EQUAL TO 215.42 FOR MODERATELY POOR, 103.05 FOR VERY POOR, 262.44 FOR ALL YOUNG HOUSEHOLDS, 115.79 FOR YOUNG MODERATELY POOR, AND 56.39 FOR YOUNG VERY POOR. FOR MODERATELY POOR THE INCOME VARIABLE WAS SET EQUAL TO 46.31 WHICH REPRESENTS THE MEAN HOUSEHOLD INCOME FOR HOUSEHOLDS IN THE LOWER HALF OF THE INCOME DISTRIBUTION. FOR VERY POOR THE INCOME VARIABLE WAS SET EQUAL TO 22.16 WHICH REPRESENTS THE MEAN HOUSEHOLD INCOME FOR HOUSEHOLDS IN THE LOWEST 20 PERCENT OF THE INCOME DISTRIBUTION. FOR BLACK, THE RACE VARIABLE WAS SET EQUAL TO 1.00. FOR RURAL, THE URBAN VARIABLE WAS SET EQUAL TO 0.00.

Mr. WIRTH. Thank you, Mr. Bryson.

Mr. Cresse.

STATEMENT OF JOSEPH P. CRESSE

Mr. CRESSE. Thank you, Mr. Chairman. Let me just take a moment to congratulate the committee on the thrust that they have taken in the bill.

I have reviewed it, we have reviewed it in Florida, sir, and the objectives which you have stated would be accomplished, I think we would find, to be fully in agreement with.

Not only have you stated the objectives of maintaining universal service while introducing competition, you have put some mechanics into your bill which will help obtain those objectives.

Those are not apparent in either S. 898 or in the proposed A.T. & T. settlement. I think there are many issues, however, people will agree upon. I think the single issue every party is in agreement on is that Congress must do something to establish national telecommunications policy in 1982.

The issue is too long to be carried out any further, and Congress is the only group that should establish national telecommunications policy.

So I suggest, sir, that you have got to act, and you should act in 1982. It seems to me that your bill recognizes that the objective of introducing competition while maintaining universal service must be achieved in some manner.

I think we never want to forget that very few people would think they are benefitting from competition, if, in fact, as a result of introduction thereof, their local rates were more than doubled.

I think we need to keep that in mind as we move forward to change these policies. In comments about the A.T. & T./Department of Justice settlement, someone said that they thought that maybe A.T. & T. walked away with all the marbles. I would add that I think they also took the playing field with them when they left.

It seems to me that if you are going to divest the operating companies from the manufacturing or long-distance services that those operating companies should be free to compete with their previous parent.

That proposed settlement would prohibit them from competing. The operating companies are providing CPE equipment today. Today, one single person could be held responsible for the quality of your service.

Your bill proposes the method of deregulating that, which seems to be very satisfactory. I see no reason why, once it becomes deregulated in accordance with your bill, why the operating companies of Bell should not be able to compete with what is now their parent.

It just doesn't make any sense to me. I don't see how it enhances competition to shut off the largest portion of what could be your potential competition.

There are four areas that I think are important as we move down this line that there might be some modification of in your bill. The area of exchange access charges as we move from the present settlement process appears to me to be better handled by the States, as opposed to any other body, subject to review by the FCC to see that determinations made by the States are not inconsistent with the purposes of your bill.

I frankly do not understand how one single body could make that determination for 1,500 telephone companies and 17,000 exchanges throughout the Nation. I think States recognize that if you set access charges too high, people will bypass the local network.

If you set them too low, you are going to have to increase local rates. So we have a pricing problem. I think that pricing problem can better be handled at the local level than in Washington.

It's been said that there is competition in yellow pages, therefore, do not let the States consider that as a part of local revenue.

Well, sir, if there is competition in yellow pages, we all are negligent that we haven't gotten in that business.

In Florida, for an investment of less than $600,000, Southern Bell, last year in the rate case that we just concluded, made a net profit of slightly under $33 million.

Now, if those are competitive profits, Mr. Chairman——

Mr. WIRTH. I am a little unclear on where those zeros are. Could you repeat that?

Mr. CRESSE. Yes, sir, for an investment of slightly less than $600,000, that is 5 zeros after the 6, they made a net profit after taxes, after taxes, of slightly less than $33 million.

Now if those are competitive profits, then we have all been negligent. Exchange boundaries. I think the process you set up in your bill, sir, is fine.

I just would suggset that you put in there that no county could be broken up into more than one exchange by Federal dictates.

CPE equipment, obviously, is competitive. However, until such time as telephone companies develop technology to determine from a central diagnostic place whether or not a person's trouble is in the line which would be provided by the telephone company, or terminal equipment, I would suggest you allow the States to be able to require telephone companies, always at the customer's option, to provide plain old basic telephone service so that people, as we go through this transition, will not get an immediate fast shuffle between one supplier of terminal equipment and the telephone company providing the access systems.

Thank you and we look forward to working with you over the next weeks and months.

[Testimony resumes on p. 205.]

[Mr. Cresse's prepared statement and attachment follow:]

STATEMENT OF
JOSEPH P. CRESSE, CHAIRMAN
FLORIDA PUBLIC SERVICE COMMISSION

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to present my views and those of the Florida Public Service Commission on House Bill 5158. This revision of the 1934 Telecommunications Act needs to be passed by Congress as early as possible in 1982. The recent proposed settlement of the AT&T antitrust lawsuit makes it more imperative than ever that Congress set a new national policy in this area and not leave that important policy making function to the Justice Department, AT&T and the Judicial Branch of government.

We would like to commend the Subcommittee on the approach that has been taken so far. We believe that, with a few modifications, this Bill can establish a national policy which will not only be fair to all competitors in the rapidly changing telecommunications industry, but also be fair to the consumers. If competition is to bring benefits to the people of this nation as it is supposed to, few people who have their local telephone rates increase 100% or more will be able to understand how they were benefited.

Our analysis of SB 898 indicates local rates could increase over 150% and that the proposed settlement would even be higher. This bill seems to be the best and perhaps the only hope, that universal service can remain a reality.

As state regulators, we are in frequent contact with telephone operating companies and their customers, and we hope we can be of some assistance to the subcommittee by presenting some of our concerns and by proposing improvements which will reduce the impact on local telephone rates without hampering competition.

Florida is a growth state and the continued viability of a modern communications industry is essential to us. We also recognize the importance of proper preparation for the benefits of the information age and agree that competition as a policy is far superior to regulation. But, as a state with a large number of senior citizens, it is equally important to preserve reasonable local service rates which have made the concept of universal telephone service a reality. As you know, the problem is not only in Florida and it does not concern only senior citizens. There are many people in the nation who simply could not afford to keep their telephones if rates doubled or tripled. From our analysis it appears that such increases would indeed be necessary over the next few years if either Senate Bill 898 or the proposed settlement agreement set national telecommunications policy.

In view of the President's statements favoring less federal regulation and returning more control to the states, I do not see how the Reagan Administration could endorse the bill passed by the Senate; and thank goodness, as far as I know they have not.

I particularly appreciate the confidence the President expressed in state and local governments last Tuesday, since for nearly 20 years I was deeply involved in the budget process of Florida state government. In this spirit, I suggest that you set the national policy and let us carry out our responsibility, as long as it does not conflict with national policy.

Personally, I fail to see how competition would be enhanced by having the FCC take over rate setting from the states on intra-state toll calls. As long as toll calls within the state are going to be regulated, that responsibility should be left with the states. Each state can better recognize the varying circumstances that affect costs and each state can better respond to the need of each telephone company to recover these costs by balancing the demands upon local revenues and those of intra-state tolls. The current separations procedures recognize the differences in cost from company to company in the distribution of revenues from inter-state and intra-state toll calls. States should retain jurisdiction on toll calls within the state to help soften the impact of other costs which are already being shifted to local service. By that I refer to recent changes in inside wiring and CPE deregulation.

Rather than leaving the provision of intra-state calls to competition, especially in sparsely settled areas where there is little or no effective competition, this service should remain the obligation of the principal state certificated telephone company to assure that telephone companies provide this important service on a universal basis. Another advantage of leaving intra-state regulation with the states is that the FCC would not have to take over the formidable task of overseeing the establishment of boundaries for some 17,000 local exchanges.

As in many other areas, the House Bill is more reasonable in this area than either the Senate Bill or the proposed AT&T settlement. But this responsibility would not have to be shifted to Washington at all if states retained intra-state jurisdiction. And I really do not see how it would harm competition too much if the state sets the price of telephone calls from Sopchoppy, Florida to Two Egg, Florida, so long as it is nondiscriminatory, and is done in a manner not inconsistent with national policy.

I would like to comment on three other important issues in setting a new telecommunications policy for the nation:

YELLOW PAGES-- The advertisements and listings of businesses and services, which are mainly local, have become an essential part of the local telephone service. I have only been at the Commission for three years but old hands there tell me that for many years telephone companies never claimed that revenue from this service should not be considered as local revenues. Americans are fully trained to let their fingers do the walking but now the telephone companies want to put Yellow Pages profits in their pockets and have every dollar replaced by local ratepayers.

Again, the HB 5158 has done a better job than the Senate, which would only delay this increase in local rates, or the proposed settlement, both of which would give AT&T $2 billion a year in windfall.

I do not see how that would aid competition in the telecommunications industry, but I do understand how AT&T could settle the anti-trust suit, if they are allowed to keep this windfall while simultaneously preventing the operating companies from offering this service or competing with them in any manner.

ACCESS CHARGES-- Of all of the issues in the bill, the one with the greatest immediate potential impact on local rates and the concept of universal service is access charges. The income from long distance revenues through the settlements process has been one of the primary supports for local service. Since competition would cut these contributions depending upon the final terms of the telecommunications bill, the amount of support that can be expected from this source is unpredictable. A Nationwide uniform fee schedule for access to local networks would not be a fair solution because of the varying costs from company to company, exchange to exchange. Alternatively, it is not logical to expect the FCC, either through the Joint Board concept or otherwise, to be able to establish viable access charges for each local network. We believe the states can do the best job of setting the charge according to local costs and circumstances. If Congress should decide that this important determination should be made through a formula which would consider cost, size and other factors, then I would urge you to write the formula into the bill.

Although it has not been specifically addressed, I also would urge you to provide payment from the toll billing to both the sending and receiving local network. Florida also is a tourist state and many of our visitors like to call home to brag about the sunshine, the fishing, and some of our many other attractions. The result is that we have a lot more long distance calls going out of the state than we have coming in. A proposal which only compensate the receiving local network, therefore, would not adequately compensate Florida telephone companies for the use of their local network facilities for long distance purposes.

CPE (Customer Premises Equipment)-- There is no doubt that provision of telephones and other telephone equipment for use on the customers' premises is becoming more and more competitive. In the past, however, inclusion of part of the cost of this equipment in the settlements process has contributed to keeping local rates low. We agree that telephone companies should be allowed to come up with a marketing plan that would sell embedded equipment based on state approved plans. However, there should be some assurance that a telephone company would not be penalized in a settlement or access charge procedure for getting rid of that embedded investment in customer premises equipment at an early date.

In any event, we believe the customer's ability to look to his telephone company for a plain old telephone and maintenance should not be abruptly terminated. The customer should be able to hold someone responsible. Until a telephone company can tell a customer whether his trouble is in the line or in his telephone without having him make an unnecessary trip to a telephone repair store or pay for an unneeded repair person's time, the customer should have the option of whether he wants to buy his own phone or pay to have the telephone company provide the full service. It may be some time before competition makes telephone equipment readily available to persons in rural areas. But, with the requirement I have suggested, I predict that it would not be long before the telephone companies solved the maintenance problem so the customers would not have to be left guessing about whether the trouble was in their telephone or in the company's line.

Our objections to the AT&T settlement are similar to the concerns addressed in HB 5158. It is easy to understand why AT&T, long confined by lawsuits and regulation, would agree to the settlement recently proposed. What is hard to understand is why the Justice Department approved a settlement allowing the overnight transfer of Yellow Pages revenues, long distance lines and CPE from the local operating companies to AT&T. I agree with the recent quote, "Some of us think AT&T took home all the marbles." It's bad enough that all Yellow Pages revenues, CPE and Long Lines are taken away from the BOC's. But the Consent Decree prohibits the BOC's from initiating service in any of these areas. Not only did the operating companies lose the marbles, they lost the playing field as well. I do not see how keeping the local operating companies out of these markets, once they are fully divested from AT&T, can increase competition. This will decrease competition, and increase local rates, while simultaneously eliminating customer choice to have plan old telephone service from one supplier.

These are some of our major concerns and, again, I appreciate the opportunity to present them to the Subcommittee. Your staff has done an excellent job in assisting us in understanding this bill and has been very helpful to our staff. I have prepared amendments which I will give to the Subcommittee staff for your possible consideration and I can assure you that we will do the best we can to provide any assistance you may wish.

A more detailed analysis of this problem, the suggested improvement and reasons therefore is attached as Appendix "A".

Appendix "A"

ANALYSIS OF FLORIDA PUBLIC SERVICE COMMISSION POSITION ON HR 5158 AND AT&T SETTLEMENT

The Florida Public Service Commission supports HR 5158 and appreciates its approach to protecting telephone users and ratepayers. We urge the Congress to adopt this legislation in 1982. HR 5158 is an intelligent approach to the complex problem of securing the benefits of competition for all. The Subcommittee and its staff should be commended for the bill.

Senate Bill 898 and the proposed AT&T settlement wouild introduce competition into the telecommunications industry by sacrificing universal local service at affordable prices. Either approach could more than double local service rates.

There is no need to double local rates to introduce competition into the industry. Nor is there need to give AT&T a windfall of 2 billion dollars in Yellow Pages revenues to introduce competition. Competition is needed, but it should be introduced for the benefit of all, not just a few.

Our analysis of HR 5158 has disclosed only four major concerns. These are summarized on the attached schedule, along with corresponding proposals to strengthen the bill in these areas.

ANALYSIS OF FLORIDA PUBLIC SERVICE COMMISSION

PROPOSALS FOR STRENGTHENING HR 5158

AREA OF CONCERN	PROPOSAL	COMMENTS
A. EXCHANGE ACCESS CHARGES - FCC/TJB sets access charges	Allow states to set access charges or at the very least allow states to deviate from uniform charges set by FCC/TJB, to recognize differences in local exchanges.	1. Ability to set access charges necessary to state fulfilling its responsibilities as caretaker of exchange areas. 2. Access charges are crucial to support for local exchange service. 3. When access charges too low, local exchanges hurt; when access charges too high, necessary long distance communications impeded. 4. Appropriate level for local exchanges can only be set with awareness of local conditions. 5. 1,500 companies and 17,000 local exchanges - FCC/TJB cannot review each with any sensitivity to local conditions. 6. State commissions closer to local subscribers and, therefore, more responsive to legitimate local interest. 7. Locally set access charges should be consistent, however, with national policy. 8. Split authority between states and FCC/TJB inherently inefficient. 9. Present separation procedures recognize differences in cost of service between localities. This should continue in access charges, but unlikely under FCC/TJB approach.

ANALYSIS OF FLORIDA PUBLIC SERVICE COMMISSION

PROPOSALS FOR STRENGTHENING HR 5158

AREA OF CONCERN	PROPOSAL	COMMENTS
B. YELLOW PAGES - Precludes states from considering yellow page revenues, even though impact is softened by fair value purchase requirement.	Treatment of yellow page revenues should be left to discretion of the states.	1. Historically yellow pages has been integrated with regulated enterprise. 2. Yellow page advertising is an integral part of local service. 3. Americans have been trained to let their fingers do the walking. 4. Revenue generated by yellow pages is crucial to universal local service at affordable prices (2 billion dollars for AT&T alone). 5. Yellow pages not truly competitive - telephone companies have better access to listing information. 6. Proposed compensation to ratepayers for loss of yellow page revenues under HR 5158 uncertain, with valuation being key. TJB can't address this issue individually for each of 17,000 exchanges. 7. Local operating companies operate under a grant of state authority.

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ANALYSIS OF FLORIDA PUBLIC SERVICE COMMISSION

PROPOSALS FOR STRENGTHENING HR 5158

AREA OF CONCERN	PROPOSAL	COMMENTS
C. EXCHANGE BOUNDARIES - May unnecessarily restrict state discretion in setting exchange boundaries	Assume county-wide local service is at state's discretion.	1. TJB cannot handle oversight of over 17,000 exchanges. 2. At least no law should prevent a single county in Florida from being an exchange.
D. CPE - States cannot require regulated company to provide a telephone as part of the basic service	Give states the authority to do so.	1. Unavailability of sufficient supplies and repair service in rural locations. 2. State should have option to require sale of in-place equipment, with protection for states taking early action (states that delay keep rate base high and could unfairly profit in settlement procedures and/or cost-based access charges). 3. CPE is competitive and should be priced at cost plus a return on investment. 4. Removal of CPE causes loss of local exchange revenue support.

ANALYSIS OF FLORIDA PUBLIC SERVICE COMMISSION

PROPOSALS FOR STRENGTHENING HR 5158

AREA OF CONCERN	PROPOSAL	COMMENTS
D. CPE - (continued)		5. States should value CPE transferred from regulated company. 6. There should be no abrupt termination of present CPE provision - depreciation approach of HR 5158 does not insure this. 7. State commissions should be allowed to continue to require provision of a plain telephone instrument, at fully compensatory rates, as part of basic telephone service. This will protect customers from the "not our fault" runaround from dual suppliers. 8. Customers will suffer from split responsibility for segmented service. They should have option to hold local operating company responsible for basic core service. 9. Anything but plain old telephone service can be deregulated and taken out of rate base in a time certain.

Mr. Wirth. Thank you very much, Mr. Cresse. We thank you and your colleagues for your help.

All the way through this process, you all have been very good to us in providing your suggestions since we started to draft this legislation last fall.

I note that at this point, because you, Mr. Cresse, have been in, around, and about on a steady basis. You can find your way around the Rayburn building without getting lost at all. We appreciate it.

Mr. Hipp.

STATEMENT OF EDWARD B. HIPP

Mr. Hipp. Mr. Chairman and members of the committee, I appreciate the opportunity to present these comments on the House bill.

I think one thing that has not been said is the difference that might result in the different geographical areas of the country from deregulation.

I think all studies have shown that deregulation, particularly of the total revenue contribution, would impact the rural areas, the small exchange areas of the country, much greater than they will the large exchanges.

Most of the studies that show a doubling of rates on the large exchanges show also a tripling of rates on the small rural exchanges where the toll contribution represents a greater percent of the revenue of the telephone company because the distribution loops are much longer, serving a much smaller number of people.

The contribution of toll must be greater if the toll is to reach those people and to be available to those people. We think that the bill, in its objectives, is exactly what we need to preserve universal telephone service at affordable rates.

To be universal, we couldn't increase rates to the extent people would lose their telephones service. I think something else that maybe should be emphasized is the essential service of telephone communications. It is vital to the national health and welfare and safety.

Now we have a 911 program which would offer tremendous help to people in seeking medical aid or law enforcement assistance or any other emergency fire assistance. But it will not help if the rates are so high that 9 percent or 20 percent of the people lose their telephone service because of the increase in the price.

In the comments I have filed, I have made eight suggestions or requests for amendment in the bill, not in every case because of amendments to the bill itself, but because of amendments that are needed to deal with the consent decree. As I understand it, both the bill and the consent decree were the subjects of this hearing.

I would add one other thing before getting into those eight requests. Deregulation has already begun under the FCC computer II inquiry. We are getting increases in telephone rates at the present time, and they will continue to escalate under the FCC regulations unless some assistance is given by Congress to the States in dealing with those FCC regulations.

The FCC will have an access charge plan which will deregulate the toll service. The FCC is deregulating customer premise equipment. They are changing the depreciation rates, and they are changing the rules on inside wiring and for expensing of inside wiring.

All of those things are increasing local telephone service on a gradual basis, and the customers have not begun to feel the full impact.

But they will fall in within the next 2 or 3 years, in our view, in such a way that then the service will be threatened.

On the eight points, I will briefly just list them because I think most of them have been covered already. The access charge, we think that the bill has a fine formula of 100 percent, excuse me, trying to protect 110 percent increase in the local rural exchange.

But if the big exchanges have gone up 100 percent, the 110 percent doesn't help. So we think the, still, beginning need is to slow down increases all across the board. The access charge should protect the present revenue, present contribution.

Many of the supporters of the access charge feel like the local exchange customers should pay for the whole cost of the local exchange and that the outside providers should come in for a nominal fee.

We think that is the policy, or fallacy of the deregulation of toll service. They must pay their fair share and full contribution at the present level for all of that plant, because that plant is not built or designed for local service.

It was built and designed, and most of the cost of that local plant, particularly the upgrading of the local plant, digital service, has been to serve the outside providers.

Now on the intrastate toll, it would, no doubt, no longer continue in the same form. But we think the access charge for the intrastate toll will equate to it, it should equate to it and the State commission should retain that jurisdiction.

On the boundaries, we feel the boundaries encompass more than just boundaries, they encompass rate designs that go across boundaries. Those rate designs for extended area service and other types of service, wide-area service, should be left to the States, because they know the geographic and geopolitical situation in those States.

The directory listing, everyone has mentioned it. It is vital in North Carolina in the Bell System exchange. To lose the directory advertising would cost the residential ratepayers $1.14 a month, on the calculations which we have on their telephone rates, to replace that revenue.

The only purpose, as we see it, is to have availability of directory advertising from any source that wants to enter it. Well, that is presently available.

We think it would be a mistake, not only for the revenue purposes, but for the convenience of the customer to have a telephone book that classifies the numbers that he can call, not only alphabetically, but classify them by use.

That is all that the yellow pages are. If they can support themselves and make a contribution to the telephone plant which causes them to exist, that contribution from advertising should go to support that same plant that the yellow pages are based upon.

We think it is a mistake to construe yellow pages as just some other form of public advertising—it is not. In our view, it is totally tied to the exchange which it serves.

Now, the assets evaluation, I think, has been covered well. We think the States have a vital role in valuing the assets if the Bell System is to be split up.

We think that, of course, that seems to be the rule that both the bill and the consent decree go to. We support, also, the customer choice as to where he would get his telephone. The deregulation plan contemplates that the local telephone exchange could not provide a telephone set to a customer.

We feel that that is a disservice, a degrading of service. The customer should have a choice. If he doesn't want to go out and buy his phone and maintain his phone, we see nothing in the national policy that should prevent the telephone company from being able to provide and maintain a telephone to that person.

All people are not of a nature they would like to buy appliances, install them and rewire their house. Some people want an appliance, some people need an appliance to be maintained by the supplier.

Now a telephone set is an integral part of the wire. It is not like a variety of appliances that might hook on to an electric system. You subscribe to a telephone service. The one thing you want is a good operating telephone.

Mr. Chairman, I close with my last point, on the quality of service. Under the consent decree, and I think under the bill and most deregulation plans, the local exchange would be open on a tariff basis to any outside provider who wants to use it, any toll or information provider.

Some of them will be regulated. But we would foresee that most of them would not be regulated. Any information provider can come to the telephone company and call on the telephone company to open access to him of all of that exchange, to wire into it for origination and termination of his service.

We have had experience in North Carolina with some fraudulent plans to use the local exchanges for that purpose. We think there needs to be some control over who would use the local exchange, and that the public utility commission should have a role in that.

I thank you for this opportunity.

[Testimony resumes on p. 221.]

[Mr. Hipp's prepared statement follows:]

STATEMENT OF
EDWARD B. HIPP, COMMISSIONER
NORTH CAROLINA UTILITIES COMMISSION

Mr. Chairman, and members of the Subcommittee, my name is Edward B. Hipp. I am a Commissioner of the North Carolina Utilities Commission and the Vice Chairman of the Committee on Communications of the National Association of Regulatory Utility Commissioners, commonly known as the "NARUC."

I file these comments as an individual State Commissioner, but they also reflect in the main the position of the NARUC expressed by Resolution adopted on November 18, 1981, at its 93rd Annual Convention.

I am also a member of the Federal-State Joint Board established by the Federal Communications Commission in CC Docket No. 80-286, to consider rules on separations and settlements of interstate toll revenue, including the effects of deregulation of customer premise equipment and access charges in lieu of present settlements procedure, but the views expressed here do not necessarily reflect views as a member of that board.

The North Carolina Utilities Commission is a regulatory agency established by the State of North Carolina to regulate public utilities in North Carolina, including telecommunications under the following jurisdictional definition of a public utility to include "conveying or transmitting messages or communications by telephone or telegraph, or any other means of transmission, where such service is offered to the public for compensation." N.C.G.S. 62-3(23)a.6.

The Commission is designated to represent consumers before Federal courts and agencies.

The North Carolina Utilities Commission has a Commission Staff of 70 employees, and there is a separate Public Staff representing consumers with 85 additional employees, such staff including attorneys, accountants, engineers and economists, and a budget of $4,200,000 per year for the purpose of regulating utilities. The Commission holds public hearings on all applications for rate increases and service problems and issues formal Orders fixing the rates and regulating the standards of service of all public utilities in North Carolina.

I appreciate your invitation to present views and comments on H.R. 5158, a Bill to amend the Communications Act of 1934, and including comments on the recently announced settlement of the Department of Justice's pending anti-trust suit against American Telephone and Telegraph Company (AT&T) and the attendant modification of the 1956 consent decree proposed by AT&T and the Justice Department.

I am extremely pleased that the legislation supports a continued commitment to universal telephone service at affordable rates, and at the same time provides the benefits of competition to consumers where deregulation is feasible and helpful to telephone customers.

I believe there are many mutual goals of H.R. 5158 and the State Regulatory Commissions for telecommunications reform, and believe that with some amendments in the proposed H.R. 5158 and the January 8, 1982, anti-trust settlement, that great progress can be made to this mutual end.

The major features of the comments and requested amendments which I present are summarized as follows:

AMENDMENTS TO PROTECT LOCAL EXCHANGE CUSTOMERS AND PRESERVE AFFORDABLE LOCAL EXCHANGE TELEPHONE RATES

1. ESTABLISH LEVEL OF ACCESS CHARGES EQUIVALENT TO THE PRESENT CONTRIBUTION BY TOLL REVENUE FOR JOINT USE OF THE LOCAL PLANT, WITH PARTICIPATION BY STATE COMMISSIONS IN FIXING THE ACCESS CHARGES.
2. PROVIDE STATE JURISDICTION OVER ACCESS CHARGE FOR INTRASTATE ACCESS TO LOCAL EXCHANGES.
3. STRENGTHEN STATE JURISDICTION OVER LOCAL EXCHANGE BOUNDARIES AND EXCHANGE SERVICES.
4. CONTINUE STATE REGULATION OF RESALE OF INTRASTATE TELECOMMUNICATION SERVICE.
5. CONTINUE STATE AUTHORITY TO CONSIDER DIRECTORY ADVERTISING REVENUE FOR LOCAL RATEMAKING PURPOSES.
6. PROVIDE FOR STATE COMMISSION REPRESENTATION ON ASSETS EVALUATION BOARD.
7. CONTINUE CUSTOMER OPTION TO CALL ON THE LOCAL TELEPHONE UTILITY TO PROVIDE A BASIC TELEPHONE SET.
8. PROVIDE FOR STATE COMMISSION JURISDICTION AND PARTICIPATION IN A PERMANENT JOINT BOARD TO CONTROL QUALITY OF SERVICE FOR ACCESS TO LOCAL EXCHANGES BY TOLL PROVIDERS, INFORMATION PROVIDERS, AND OTHER PARTIES GRANTED SUCH ACCESS.

DISCUSSION

1. ESTABLISH LEVEL OF ACCESS CHARGES EQUIVALENT TO THE PRESENT CONTRIBUTION BY TOLL REVENUE FOR JOINT USE OF THE LOCAL PLANT, WITH PARTICIPATION BY STATE COMMISSIONS IN FIXING THE ACCESS CHARGES.

The major concern of all State Commissions in representing local service customers in the restructuring of telecommunication service is the effect on local rates from the establishment of access charges to the local exchange in lieu of the present toll separations and settlements procedure.

There have been numerous public comments from many knowledgeable sources within the telecommunications industry estimating varying local rate increases resulting from the deregulation of interexchange service and the substitution of access charges for present toll revenue settlements.

Many of these estimates predict an increase of 100% in the local rates, i.e., "double the local rates" from the combined effects of telephone legislation. The principal effects referred to are the loss of toll contribution for joint use of exchange plant, loss of yellow page revenue, the increase in depreciation rates, and restructuring of on-premise wiring and installation charges.

The major revenue impact from these changes is the elimination of present toll separations and settlements revenue, and establishing an undefined "access charge" in lieu of the revenue requirement assigned to toll revenue.

As an example, Southern Bell in North Carolina had total revenue to provide North Carolina service in 1981 of $800,958,000 from the following sources:

Local Service Revenue	$346,796,000
Intrastate Toll Revenue	196,173,000
Interstate Toll Revenue	227,468,000
Miscellaneous Revenue	37,356,000
Intrastate Uncollectible Revenue	(3,152,000)
Interstate Uncollectible Revenue	(3,683,000)
Total Operating Revenues	$800,958,000

With local service revenue of $346,000,000 and combined toll revenue of $423,000,000, it is immediately clear that the loss of the toll revenue without offsetting equivalent access charges would require that local rates be more than doubled to continue the same service by Southern Bell in North Carolina without the toll revenue, reduced by the amount of Southern Bell plant in North Carolina which would be transferred to AT&T under the January 8, 1982, anti-trust settlement.

Southern Bell provides only one-half of the telephone service in North Carolina. Twenty independent telephone companies provide the other one-half of telephone service in North Carolina, and the contribution from toll revenue to the smaller rural independent companies is greater than in the case of Southern Bell. The State Commissions are clearly concerned that H.R. 5158 and the anti-trust settlement do not give any clear assurance that the access charge will produce contributions to the local exchange from use by toll providers and information providers that would be equivalent to the present revenue from interstate toll and intrastate toll for support of the local exchange service.

Both H.R. 5158 and the anti-trust settlement provide for an "access charge," but the language of the provisions is so general and so vague as to leave it impossible to make any reliable estimate of the effect of these changes on local service rates.

It is known that some of the new toll providers are seeking access charges on the basis of local monthly line charges. On the other hand, local customers need full equivalent settlement contributions, if they are to retain affordable local rates. No one can give a responsible opinion as to where the final access charges will be fixed. H.R. 5158 provides for State participation in the access charge for three years at present revenue levels, but after three years there would be no standards for the access charge. Representatives of the Justice Department have been quoted as saying that the FCC would approve the interstate access charges and the State Commissions would approve the intrastate access charges. The basis of this opinion is not evident from the terms of the anti-trust settlement itself and would be resolved only in extensive litigation, absent clarifying legislation.

One of the greatest misconceptions of the present telecommunications debates is the constant reference to the payments made from toll service for joint use of local plant as a "subsidy." Numerous spokesmen for toll providers and information providers refer to any payment to the local exchange from the outside users as a "subsidy." They argue that the local exchange local ratepayer should pay for the entire local plant in local monthly rates, and that any other outside service accessing the local plant should not have to pay for such access, other than standard local service customer rates. The fallacy of this misnomer is so evident that it should not require argument, except it is in danger of being accepted through repetition. The entire local plant is used jointly by the toll providers and information providers, along with the local service users, including the switching network, the central office network, and the outside distribution plant, local loops and line drops. Even more important to the toll obligation, the entire plant has to be designed to standards for joint toll use, as the higher quality of service, and much of the vast expenditures for upgrading switching equipment and local plant design to electronic and digital equipment have been made to meet the high standards of use for toll providers and information providers.

If local telephone customers are to be protected and continue to receive affordable rates, it is essential that H.R. 5158 and the consent decree be amended to provide clear and unequivocable language establishing the access charge at levels of revenue equivalent to the present return paid by toll providers for their part of the exchange investment used jointly by toll and information providers and local customers in the form of toll separations and settlements.

2. PROVIDE STATE JURISDICTION OVER ACCESS CHARGE FOR INTRASTATE ACCESS TO LOCAL EXCHANGES.

Many of the arguments under this heading have been included under Item 1 above dealing with access charges in general. On the specific service of intrastate access charges, the State Commissions urge that the provisions of the January 8, 1982, anti-trust settlement (as construed by one spokesman for the Justice Department) be written into H.R. 5158, making clear that the State Commissions would have jurisdiction over the access charges for messages originating and terminating in the same State as the local exchange, i.e., intrastate access.

The local exchanges in the 50 States vary to such a degree in geography and demographic conditions that it will not be possible to fix uniform access charges at the Washington level for intrastate access charges which are equally just, fair and reasonable in all 50 States. This determination should be left to the State Regulatory Agency charged with the regulation of utilities in each State.

3. STRENGTHEN STATE JURISDICTION OVER LOCAL EXCHANGE BOUNDARIES AND EXCHANGE SERVICES.

The State Regulatory Agencies have developed a variety of rate designs for telephone rates between communities with a community of interest in proximity to local central offices. These rate designs have been tailored for local geographic, geopolitical and demographic conditions. Some local exchanges have extensive calling scopes to all surrounding areas, some have extended area service between several separate local exchange offices, and others have a variety of local measured service rate plans, extended community calling plans, and some may have one-way extended area service, all designed to meet local conditions. They have a substantial rate impact upon the rates to support local exchanges. The boundaries of the local exchanges are affected by such local area and wide area rate designs. They have a major effect on the success of the emergency 911 telephone service. The January 8, 1982, anti-trust settlement establishes a new standard for telephone exchange boundaries utilizing in part the "standard metropolitan statistical area." While this offers some opportunity for protection of local service areas, it is a new concept in North Carolina, and I believe in most States, as far as telephone boundaries are concerned.

There will undoubtedly be disputes between toll providers and information providers as to what constitutes local service between various exchanges and what constitutes access charges for outside providers. The resolution of the boundaries and rate designs will have a major bearing upon local service revenue and local service rates.

The States strongly urge the Subcommittee to adopt clear provisions giving the State Regulatory Agencies jurisdiction over all aspects of local service boundaries and all local area rate designs. A permanent FCC-State Joint Board might be established to have final jurisdiction over resolution of disputes in this area.

4. CONTINUE STATE REGULATION OF RESALE OF INTRASTATE TELECOMMUNICATION SERVICE.

The establishment of the right of telephone customers to resell telephone service offers many new advantages to customers, both as resellers and as purchasers from resellers. The many varities of such resale service that might be developed are substantially unforeseeable and the effect upon telephone service and telephone revenues is unforeseeable. This effect on service and revenue will be so great in the local exchange and in the local exchange rates that State Commissions should be given jurisdiction to participate in the regulation of such resale service, and the Bill should provide for a permanent Federal-State Joint Board established by the Federal Communications Commission for this purpose.

5. CONTINUE STATE AUTHORITY TO CONSIDER DIRECTORY ADVERTISING REVENUE FOR LOCAL RATEMAKING PURPOSES.

The use of directory advertising or "yellow page" revenue in local ratemaking has been a major source of revenue in fixing local rates for many years. It is a logical revenue support arising from the requirement that the local telephone company furnish its customers with a telephone directory in order that the telephone service can be usable. The directory should have alphabetical listings, as well as listings classified by services from business, commercial and industrial suppliers. If this service can logically develop advertising revenue to help support the service, it is logical that the revenue coming from an essential part of the local telephone service should support the local telephone service.

It is very impractical to say to the local telephone company that you shall provide a telephone directory of alphabetical listings, but that you shall not include any classified listings or "yellow pages" because they will be provided by competative enterprises. Beyond the loss of this revenue support, the competative enterprises may provide adequate classified directories only in major urban areas, and not find it profitable to distribute yellow page directories in rural areas for rural services and for rural customers.

The revenue from yellow pages in North Carolina provides $16,000,000 of revenue which would require $31,000,000 of rate increases to replace if it is removed from local rates, and would require an increase in local rates of $1.14 per month, if this revenue is removed from local rates. Congressional Record, October 1, 1981, pp. S11139-S111-40. If the revenue from yellow pages is lost on a nationwide basis, the increases would range from $5.50 per month in Alaska to $.71 a month in the District of Columbia, with most States requiring increases from $1.50 to $2.00 per month. Congressional Record (citation above).

6. PROVIDE FOR STATE COMMISSION REPRESENTATION ON ASSETS EVALUATION BOARD.

The January 8, 1982, anti-trust settlement provides for extensive transfer of property from Bell operating companies to AT&T, including all customer premise equipment and substantially all interexchange equipment or toll equipment. The determination of the value assigned to this transfer is vital to the local exchange rates in securing adequate compensation for such property.

The States ask for clear provision for State participation in the Joint Board making this determination.

7. CONTINUE CUSTOMER OPTION TO CALL ON THE LOCAL TELEPHONE UTILITY TO PROVIDE A BASIC TELEPHONE SET.

The January 8, 1982, anti-trust settlement provides that all customer premise equipment of Bell operating companies be transferred to AT&T and H.R. 5158 provides for gradual deregulation of all customer premise equipment.

This deregulation will offer many advantages to those persons who desire to use and can afford to use the many new innovations in equipment that will be offered to business and residential customers, including computer enhanced telephone sets and other station apparatus. Other customers may save in their local rates by providing their own equipment rather than leasing at telephone company rates. Experience to date does not indicate that all customers want to provide their own equipment and maintenance of their own customer premise equipment, and it would appear that there will remain a certain number of customers who do not desire to purchase a set or to maintain a set and who would prefer for convenience or for other reasons to be able to call on their telephone utility to provide full basic telephone service, including the installation and maintenance of a basic telephone set. For many customers, the denial of the right to secure such full basic telephone service will be a degrading of the telephone service. This will not be as apparent in large urban areas with many competing appliance services to provide telephones as it will be in the rural areas where there will be no appliance services who will install or service customer premise equipment.

Some residual option should be left to the customer to determine how he would obtain his customer premise equipment, including the option of calling on one of the local sources of equipment, i.e., the regulated telephone utility, at tariffed, regulated rates.

8. PROVIDE FOR STATE COMMISSION JURISDICTION AND PARTICIPATION IN A PERMANENT JOINT BOARD TO CONTROL QUALITY OF SERVICE FOR ACCESS TO LOCAL EXCHANGES BY TOLL PROVIDERS, INFORMATION PROVIDERS, AND OTHER PARTIES GRANTED SUCH ACCESS.

The State Commissions are charged under State law with the duty of regulating the quality of service of telephone utilities offered within each State. Both H.R. 5158 and the January 8, 1982, anti-trust settlement seem to leave this responsibility and jurisdiction to State Commissions. State Commissions support this entirely and believe it is the only logical place for such service regulation to be assigned.

There will be major new innovations in service which will come with competition, including new services from toll providers and information providers. They will present new problems in maintaining the standards and quality of service in the local exchange.

The January 8, 1982, anti-trust settlement provides that all toll providers and information providers can have full access to all local exchanges.* The toll providers will presumably be regulated as communications carriers of some type. This creation of unregulated information providers as a new category of access users presents an opportunity for uses which cannot be estimated or forecast under the language of the settlement. If local exchanges are to be opened up to access to any and all comers, it is essential that the State Commissions be given clear authority to provide protection of the local exchanges if they are to maintain high standards of service.

While this clear State jurisdiction is needed on a stand-alone basis, it will be necessary to recognize the interest of the FCC in any local standards governing access of interstate service providers.

For this reason, it is requested that H.R. 5158 provide for a permanent FCC-State Commission Joint Board to control or review the standards of access for toll providers and information providers so that there can be some semblance of order in the demands that would be made upon local exchanges to provide access for outside services.

*Appendix B, Para. A.1.

Mr. **Wirth**. Thank you very much, Mr. Hipp.

Let me start with a broad question. There has been significant discussion about the legislative agenda since the settlement.

Three different arguments have been made. First, that there is no need for legislation at all following the settlement.

Second, that we should not have legislation until we see where the settlement comes down and what the structural arrangements look like 6 months out, which means legislation probably in the next Congress.

And the third argument is that we ought to have legislation now to supplement and deal with a variety of those issues.

Those seem to be the three choices being urged upon the subcommittee at this point: To have no legislation, to have legislation in the next Congress, or to have legislation now.

Would you all comment on those three choices Mr. Burke?

Mr. **Burke**. Yes; if I could lead off, I think speaking individually, and also as president of NARUC, we think that the third option is the clear option.

Mr. **Wirth**. Legislation now?

Mr. **Burke**. Legislation now.

Mr. **Wirth**. Mr. Schneidewind.

Mr. **Schneidewind**. Well, I think it is absolutely imperative to have legislation now for two reasons. Number one, if that settlement agreement does go into effect as proposed, the impact on the customers of each and every State will be disastrous.

But the second thing, and it is not as visible, is that even today, in contemplation of the split of the settlement, we are seeing that many people in the Bell operating companies are uncertain as to their future.

They don't know where they are going to work. They don't know which assets are going to be where. They don't know if the economic future of their entity is going to be healthy.

In fact, I get comments from the major rating services, such as Standard and Poors and Moody's, which tell me that even today, the very credit rating of those operating companies is being re-examined.

So we have an immediate and potentially undesirable financial impact. So there is a need for rapid action.

Mr. **Wirth**. Mr. Bryson.

Mr. **Bryson**. Mr. Chairman, we likewise feel very strongly that the need for legislation exists, that legislation should be passed out of the Congress now.

The alternative, very clearly, is to defer to, we think, an unwarranted extent to the details of the antitrust settlement as the shaper of the future of the Nation's telecommunications policy.

We have sought to intervene in the court proceedings. That intervention has been denied. We think that is not the proper forum for resolving the myriad of critically important detailed questions this subcommittee and subcommittee staff have been struggling with for a long time which are not spelled out at all in that antitrust decree.

If the antitrust decree stands, and even if it stands only for 6 or 12 months, what we will have is a process of extraordinary uncertainty, number one, and a relatively private process in which

A.T. & T., owning the local operating companies, will largely spell out the terms for allocating the benefits of directory advertising, taxes, patents, good will, transfer of assets.

We think that Congress, having looked at this issue for several years, should act now. It is the most legitimate body to act, and it is in our judgment the only body that can preserve universal telephone service.

Mr. WIRTH. Mr. Cresse.

Mr. CRESSE. Mr. Chairman, as I said in my opening remarks, I think it is even more imperative that you act now as a result of that. I think if I understand the settlement a little bit, it says that A.T. & T. will submit a proposal for a divestiture plan within 6 months.

I would hope the Congress would have set the national policy before the time frame of 6 months has run.

Mr. WIRTH. Mr. Hipp.

Mr. HIPP. Mr. Chairman, I would certainly support the need for legislation now. Not only because of the consent decree, but because of the deregulation that is taking place today under the FCC Computer II regulations.

And there needs to be congressional guidance immediately.

Mr. WIRTH. Mr. Burke, we have five here feeling legislation now is crucial. Can you comment on how the other 45 State public utility commissions might feel about this issue?

Mr. BURKE. I can comment on 39 of them, Mr. Chairman, who were present yesterday, and conversations with others. I think that the feeling is virtually unanimous.

I must say, however, that there is some skepticism. We have seen the problem in past years, Senate and House committees have dealt with this complex legislation and have been unable to, in a short time span, accomplish legislation.

I can say on behalf of NARUC that we will cooperate fully. Many of my colleagues have been working with you, sir. I think that the rest of us are ready to do this.

We think that there is an urgency. I just want to cite what Eric Schneidewind said and emphasize it.

I feel very strongly that in the negotiations between the operating companies and A.T. & T., the operating companies ought to be made independent before the negotiations commence, because some of us in the State commissions now already have the uncomfortable feeling that someone may be talking for a local operating company who may end up with A.T. & T.

We think that that is a very difficult position, both for that individual or individuals, and for those of us who are trying to regulate. So I would say we think there should be. We think there is going to have to be cooperation between the Senate and House.

We are ready to rollup our sleeves and work with you, sir, on this.

Mr. WIRTH. Fine, we appreciate all of your help today. I would say that the issues raised by the settlement of January are not new to any of us. They are now put out in starker relief because of all of the headlines and the discussion of the sharp increase in rates.

But that was an issue before the settlement as you all pointed out, and we have attempted to focus on it in H.R. 5158.

A second issue is the viability of the operating companies to make sure that they continue to provide the kind of excellent service to which we have become accustomed and to have the incentive to continue to upgrade their system. This is a familiar issue, put into a different kind of a context, given the separation.

A third issue which none of you addressed this morning, is the relationship between the regulated long-distance entity and the competitive Western Electric entity in the new parent company. This raises the possibility of cross-subsidies, which is an issue very familiar to the subcommittee that all of us have discussed over the last few years.

Another issue that exists is not addressed in the settlement at all, nor can it be. This is the issue of defining jurisdictions between the FCC and the State public utility commissioners, which is not in the realm of the courts to do. That can only be done in the law.

There is a lot of clarification that has to be done to then get to the next issue of who sets the access charge and what kind of process we set up.

Clarification of that jurisdiction and the simplification of the FCC's role can only be done by the Congress in rewriting the Communications Act.

So, again, the issues we are looking at are not new. They are just put now in a starker relief because of the settlement. I believe you all feel that there is a great sense of urgency now to address each one of those familiar issues.

Mr. LUKEN. Would the gentleman yield?

Mr. WIRTH. We are going to operate on the usual rules as to when people arrive.

Mr. Moorhead.

Mr. MOORHEAD. It dealt with one of your answers. I wanted a little detail on it. You said that you would spinoff the independent, the operating companies, before you did the negotiating.

Mr. BURKE. Yes.

Mr. MOORHEAD. How would you operate in the interim period? How would anyone know what their responsibilities were or what assets they had to deal with, and how would the companies go forward during that period of time?

Mr. BURKE. Well, the assets that are used and useful right now in providing basic local service are in the rate base in the several States. So I don't anticipate that there would be any short-range problem there.

I think that there could be adequate legal and accounting supervision of the funds that come in. They could operate on the same basis, Mr. Representative.

I think the real thing is that when you start to determine, under the consent decree, they are saying A.T. & T. will provide sufficient access, equipment, technological expertise and personnel to make sure the local operating companies can fulfill their functions.

Well, I think the executives of the local operating companies ought to go to the bargaining table and argue for their own best self-interest, as A.T. & T. will for itself.

I think that is in the American spirit of negotiation and compromise, perhaps, with appropriate supervision from Federal regulatory and State regulatory bodies in the process.

That is basically the problem. I don't think that there would be any problem. We would regard this as a short-range situation while the process is completed.

It was very interesting that last night we got a very strong vote on this subject after we had had a day, with all of our commissioners in from the various States. I don't think there was a dissent to that suggestion.

Mr. **Schneidewind**. And, Mr. Congressman, I guess the key thing to understand is that from those individual entities, the operating companies do operate in a highly independent fashion now in the sense that they sell their own debt. They have their own boards of directors, each one of them. The regulatory structure is in place for them to operate in a very efficient manner if they are spunoff in that way.

Mr. **Bryson**. I might address that very briefly, also. Congressman Moorhead would be familiar with Pacific Telephone in California, the largest employer in the State. In looking at Pacific Telephone, it is our judgment that it would be vastly simpler to spinoff Pacific Telephone as it now exists, with existing minority shareholders who have economic ownership only in Pacific Telephone. It could continue to operate just as it does today.

Then Pacific Telephone, the interests of which seem to us to be almost entirely synonymous with the interests that we are advancing here today, would become an ally in this effort to insure that, in allowing competition, which is certainly desirable, we at the same time move forward with a high quality, affordable basic network.

We would like to work with Pacific Telephone. The problem is now that Pacific Telephone has a very sharp economic conflict of interest with A.T. & T. And it is majority-owned by A.T. & T. So in the absence of divestiture, in fact, it is not in a position to assert its own interest.

The management of Pacific Telephone knows far better than any of the rest of us the key points in its assets which need to be retained to insure a high-quality local network.

Mr. **Moorhead**. Thank you.

Mr. **Wirth**. Mr. Luken.

Mr. **Luken**. Mr. Chairman, if the chairman would yield for just a moment, I would like to make a brief comment.

It seems to me that we are faced here with a chorus of demands for legislation and legislation now.

In the simple recitation of the problems, plus a call for legislation in the abstract, or just addressed to a few of the problems, I don't think is necessarily going to get us anywhere.

This settlement came about because of the default of Congress over the years in acting. We have been dealing with it, as the chairman has just suggested, it is nothing new, for some time.

But the Congress as a whole, this committee acted last year, the full committee acted, has not been able to act. I would just suggest that as we go along in this hearing and in our consideration, what we need is some insight as to how we can get enough of the parties together on comprehensive legislation.

If we just go ahead now on 5158 as if that is going to solve it all, we thought the other legislation proposed might solve everything else, that just might not be the way to go.

Mr. **Wirth**. Mr. Burke.

Mr. **Burke**. Well, I think the point is well taken. But I do think that if nothing else, the proposed settlement between A.T. & T. and the Justice Department has focused everybody's attention.

Sometimes it is the—you need that timeframe. You need to be cramming for exams and know there is an exam on a particular day. I say the examination of all of us is at hand now. I think the basics, in our extended testimony, I think the basics of 5158 make good sense in relation to what is going on with the A.T. & T. settlement.

I don't think we can look at it in a vacuum. Right now the State and Federal staffs on the joint board that is dealing with the separations formulas are meeting in Texas, as we are meeting here, to try to give the State and the commissions and the FCC some guidance as to how we are going to go with that joint board proceeding.

I suggest that the time is present for some close work between the House committees and the appropriate Senate committees. We will be seeing the proposed plan of A.T. & T. unfold, my understanding is that it is not going to be 6 months from now, but that segments of that plan will be delivered in very short order to the Justice Department.

It may be as they come forward that we will find that there should be certain modifications in H.R. 5158. We contemplate that.

But we think that you could go forward, take this testimony, work with the essentials. Obviously, I think we are all clear that as far as yellow pages revenues are concerned, I think we have been unanimous on that.

That is treated in your legislation. We have got suggestions on that. We have suggestions of the joint board in relation to access charges.

So I think that many of the fundamentals are already spelled out in H.R. 5158. But I agree with you fully that everybody's got to work selectively on this if we are to get a result this year.

Mr. **Luken**. Thank you, Mr. Chairman.

Mr. **Wirth**. Thank you. We have had the bill out for weeks now and scheduled hearings for people to comment on what is in the bill.

Mr. Mottl.

Mr. **Mottl**. Thank you, Mr. Chairman.

To respond to my colleague from Ohio, I think H.R. 5158 is a comprehensive piece of legislation to deal with the entire program.

Naturally it is not perfect at this point, and we can have appropriate amendments.

Mr. Chairman, I would first like to compliment you for having this hearing, and also compliment the panel for their responsiveness and outstanding opening statements.

Would the panel agree that the Bell juggernaut has steam-rolled its way through the U.S. Senate, not through the Justice Department, and that this subcommittee has the last opportunity for the American consumer of telephone service to provide reasonable rates?

Mr. CRESSE. Mr. Chairman, I might not have expressed it the same way he did.

I am serious. I don't blame A.T. & T. for signing the settlement. Clearly the time has come for national policy to be established. It has been an issue for 7 or 8 years. They have been handicapped. If I had been sitting there negotiating with the Justice Department and had an opportunity to sign that deal, I would have signed it so quick that nobody would know. So, yes; the answer is you have got to save the situation.

If you don't do something, then I, in all honesty, sir, and too Mr. Luken, think you are going to be negligent. The way to do that, if you want to force Congress to act, it seems you go to the Senate and say, "Why don't we pass a little sunset bill that would make the existing law inoperable on July 4, 1982." That would force both of you to do something by that date.

Mr. SCHNEIDEWIND. I think one point is that right now we have a situation in which concerns that have historically been fed in nature, which is to say the supervision of the national aspects of the telecommunications system, and, frankly, the attempt to make those more technologically advanced and cheaper, have been at the forefront of the national policy makers, certainly in the Senate and Department of Justice. They were offered the opportunity certainly at Justice to achieve some of those objectives in return for some things that obviously A.T. & T. wanted.

But what you have a chance to do that I think has absolutely not been done, and must be done, is, at the same time, to consider those local concerns which are centered around universal service. Those local concerns, the ones that we deal with, not the FCC, the complaint of somebody who has a poor connection, the fact some retiree cannot afford telephone service, the fact a person who is sick cannot get a hold of emergency medical service, those are concerns that rest upon us in our daily professional lives. Those are the concerns that have not been heard up until now in the deliberations of the Department of Justice, yet we think are not incompatible with the national objective of increased competition.

Mr. MOTTL. Are those local concerns taken care of by the settlement with the Justice Department?

Mr. SCHNEIDEWIND. Absolutely not.

Mr. MOTTL. That Justice Department settlement is not for the best interests of the American consumer, is it?

Mr. SCHNEIDEWIND. No, it isn't.

Mr. MOTTL. Would you agree to that?

Mr. CRESSE. In my opinion it is not, sir. I think with slight modifications of it, and I am not an antitrust expert, but if the idea is to get the dominant manufacturer separated from the distributor in a regulated environment, you do that by severing the operating companies, but leave them whole. Let them then compete. No telling what those operating companies could do if they were independent.

So the pattern is there, maybe, to solve antitrust problems and also address the issues which this committee has to address, and that is the provisions of them not being able to compete with the parent. It is just wrong.

Mr. MOTTL. I think a message should be sent from all of us collectively to the Justice Department to renegotiate that settlement in the best interests of the American people or to Judge Green to not allow it to go through without substantial motivation.

Mr. **Burke**. We at NARUC have already moved to intervene and we will be making comments under the Tunney Act. We are also engaged in discussions with A.T. & T. and with the Justice Department. I want to stress that I think that this committee holds a key role. But I also feel we all have a collective responsibility. There is the Senate, the House, the State regulators, A.T. & T. and the Justice Department.

We do think there should be some modifications in the proposed settlement. And we will speak to these. But we also feel that it is going to be very important for all of us to address this with the feeling that, while we may have differences, that we all have a common responsibility to the American people and that we are faced with a present, current situation. I for one am going to try to approach it on that basis, and talk along those lines.

I think it is very important that the committee is doing this work. I would hope it would be helpful, I think, if the committee had a series of regional hearings across the country on this subject, because I think we really have to bring and focus the attention of all the American people and business on the concerns that are going to face us in the future. We have the best telephone system in the world. We have got to face the changes in technology and changes in competition.

But I for one don't want to see it dismembered so that we look up 4 or 5 years from now and we, each of us, have a collective responsibility then for what has happened.

Mr. **Mottl**. Mr. Chairman, I have just two more questions if I may. In response to when Charles Brown, the CEO of A.T. & T. was here, I asked him about universal service and that we have 91 percent, now, coverage of the homes throughout the United States. And he said, replied to that, the proposed settlement, that you could not buy pizza for your wife for the cost of home service. But with this proposed settlement by the Justice Department and A.T. & T. and the Senate bill, I think you will agree the rates for the residential user will go up dramatically. Maybe double or triple in amount.

I would like to submit for the record, Mr. Chairman, if I may, at this point, this estimated percentage of households with basic telephone service as prepared by the Commerce Department, that shows as the rates go up for example, 50 percent, 100 percent, 200 percent, that Commerce estimates the percentage of household basic telephone service goes down dramatically.

Would you gentlemen agree that as the cost goes up that we will not have universal coverage, we will be going in the opposite direction?

Mr. **Bryson**. There is no question that is the case, Congressman. I think that is a very important document that you have cited. I have attached to my testimony a new document prepared recently by A.T. & T. that I think further conveys some of the impact of the changes which this whole series of decisions, the FCC decisions, the Senate bill, conceivably the antitrust settlement, lead to.

I just want to point to one particular area. We have been talking about a doubling or tripling of rates, setting out the loss of directory advertising revenues which basically support basic phone rates, for example. That is a very large item, $1.35 per month per customer in California, for example.

One piece of information I think is valuable and helps further to convey the problem is an analysis of the impact of changes in the formula which prescribes now how much long distance telephone providers must contribute to the cost of the local network; that is, how much long distance services assist in paying the basic phone rate. It is essential that they do so because there is no way to make a long distance phone call without getting into the local network.

The local network is what is in jeopardy here. In our judgment, unfortunately, all these decisions have focused mostly on the long distance and enhanced services, primarily the business use side of the equation. The document attached to my testimony is an analysis of the change from the existing formula to a formula called subscriber line usage, which is the formula A.T. & T. has advocated and which to a large extent has been adopted by one term or another in all these decisions.

That formula, and I am talking about only one element of the cost increase, dealing only with reduced contributions from long distance telephone providers to the local network, but that alone, according to A.T. & T.'s analysis just provided in the last month, would result in an increase in basic rates in each of the 50 States to the extent set out in this exhibit, and the rate varies I would say roughly from a 70-percent increase in basic rates just from this one factor alone, and this is just part of the equation, from 70 percent to something in excess of 200 percent.

I have each State set out here. I would pick out, for example, Denver, Colo., which may be of interest to the committee.

Mr. WIRTH. Commissioner Miller is here.

Mr. BRYSON. People always point out to me that Palo Alto, Calif., would become a long-distance call to San Francisco. But Denver, for example, the A.T. & T. analysis shows that just this one component would result in a 113-percent increase in basic phone rates in Denver, Colo. That is only one component of this picture. I think it is conservatively calculated. It is the A.T. & T. calculation, and A.T. & T. wants to move in this direction. That is a fairly representative number.

Mr. MOTTL. One last question, if I may, Mr. Chairman.

Mr. Cresse stated that in Florida based on an investment of $600,000 there was a profit after tax of $33 million. Clearly this is not competitive service at this time. Do you other commissioners report similar profitability figures for Yellow Pages in your States?

Mr. BURKE. Yes.

Mr. CRESSE. Yes.

Mr. SCHNEIDEWIND. Yes.

Mr. HIPP. Yes.

Mr. BRYSON. Yes.

Mr. MOTTL. Thank you very much.

Mr. WIRTH. Mr. Scheuer?

Mr. SCHEUER. Thank you, Mr. Chairman. Mr. Chairman, I am going to ask two or three questions, and then hope that the panel get a chance to answer them. If there is anything left over, I would ask unanimous consent that they be able to submit answers in writing.

Mr. WIRTH. Without objection.

Mr. SCHEUER. Thank you. I am going to pose my questions to you, Mr. Cresse, only because I can't appear in your State without bumping into elderly retired folks from my district, the Bronx, Brooklyn, and Queens. It is a great pleasure to see them, but it gives me confidence that you and I are operating on the same wave length because it is perfectly obvious that a major constituency of yours is your elderly.

My question would sort of take this form. It is obvious that we are concerned about the elderly, and the maintenance of their lifeline. It is also clear to me that you, and others of you, feel that we ought to let BOC's compete in unregulated segments of the business, whether it is Yellow Pages, pay TV, cable TV, computer services and the like. First, I would like you to tell me what kind of unregulated services you would like the BOC's to be able to participate in. Second, what would the financial arrangements be by which some, if not all, but certainly some of the profits of those unregulated services could go to minimizing the net increases in local rates. And third, whether you think it would be advisable to target some of that profit from unregulated services to support specific groups like the elderly who are most vulnerable to rate increases because they are living on pitifully small fixed incomes and, second, are most urgently and desperately in continuing need of that lifeline to the outside world.

Mr. CRESSE. All right, sir.

Mr. SCHEUER. Should that be a cap in order—some kind of a cap on increases in telephone service to specific groups like the elderly poor, and should that be funded in some way in some participation in the profits by unregulated companies.

Let me ask you my third question which is this. Just as we are interested in protecting groups that are particularly needful of telephone service and particularly vulnerable to rate increases, we have a complementary interest in maintaining the integrity of the national telecommunications system. We sort of feel the whole is greater than the sum of the parts.

We all have an interest in the quality of the system being maintained and, to the maximum extent possible, as many people as possible remaining on that network. There are some people who have expressed a fear that some local, State utility commissions in their zeal to maintain, to prevent all possible rate increases, will set rates at such a point that the local telephone systems will have such a limitation on their cash flow that they will not be able to maintain the integrity of the services. They will not be able to maintain their system, they will not be able to buy new equipment and stay at the top of the technological potential.

How do you assure the Congress and the American people that we will not see individual State utilities forcing a diminution of the quality of service and integrity of that service? And do you feel that there might be a need for Congress or the FCC to establish some kind of guidelines, national uniform information guidelines to State utility commissions in their establishing the new rates?

Those are my questions.

Mr. CRESSE. Congressman, let me try to answer the last question first. To kind of give you a perspective on that, first, I have heard the statements State regulatory boards are horrible and can't face reality and all these things. I would remind this group, however, that by and large, our electric utilities are completely regulated by State regulatory boards, about 96 percent. The last time I flipped my switch the lights came on. So sometimes you have to filter through all that and get down to the results.

As far as I am concerned the results for electricity service in this country, even though it is very expensive, are pretty satisfactory. The same is true about the results of local service. States have been regulating local service and local service rates, establishing depreciation, rates of return and everything else since 1934 at least. They tell me some of them were doing it prior to that. But I have only been in this business 3 years.

The question of establishing oversight or guidelines and so forth, I have no problem with, because I think the national policy has to be established by Congress. I think that States, to participate in a joint effort with the Federal Government in implementing that national policy, there have to be some guidelines.

Mr. SCHEUER. OK. Would you move on to the other questions, sir?

Mr. CRESSE. The question about lifeline rates, and that is essentially one of your questions, I have mixed emotions about that. And let me tell you why, sir. I was State budget director in the State of Florida for a while. I was in the Budget Office for 18 years. I think if Government wants to provide a specific type of service because of a person's income or age, mostly income, I believe, has been the historic principle, I think Government should assess the taxes and distribute the funds to accomplish that.

I think that is the most efficient form of government. Then those who are responsible for establishing the policy to assess the revenues on the people to pay for it, as opposed to some indirect method of the redistribution of the benefits of Yellow Pages to a target group. That is just my personal philosophy, and it stems from my long association with governmental bodies. And it is much easier for Government to do things if they don't have to pay the price, or pay the full cost.

I think you have to face that responsibility of paying the full cost.

Mr. WIRTH. Thank you, Mr. Scheuer.

Mr. Bliley. Were there others who wanted to respond to Mr. Scheuer's question? I am sorry.

Mr. BRYSON. I had one point, Mr. Chairman. I think I can make it briefly. All the points that have been made to date I think have all our concurrence whether we are Republicans or Democrats, we have all held these hearings in the local communities, we have had to deal with local problems.

I want to state one point which is a personal conclusion that may be slightly at variance with my fellow State regulators. I don't know. This is a point we haven't really been through. But my own conclusion is not that the local regulated monopolies need to go into competitive businesses and need to have that freedom. I think there is a legitimate concern evidenced in the antitrust suit, and in some of the regulation, that a regulated business provides the opportunity for the owners of that business, if they are in other businesses, to seek to extract monopoly revenues to support and subsidize competitive businesses.

I don't think that is desirable. All our testimony, and I think the bulk of the testimony you have heard this morning, perhaps all of it, are avenues that would allow the maintenance of a very strong local network at an affordable rate without the necessity of having the local companies get into unregulated businesses.

I don't regard directory advertising, the essence of directory advertising as a freely competitive business. Any small businessman in California will tell you you absolutely have to be in the Yellow Pages. There really isn't a conceivable alternative. That needs monopoly regulation in my judgment.

We also make recommendations about lines of business so integrally a part of the local exchange network—custom calling, call waiting, call forwarding, and so on, that they are right in the central equipment. We think these services need to be handled by the local companies.

Mr. WIRTH. Fine. Thank you, Mr. Bryson.

Mr. Bliley.

Mr. BLILEY. Thank you. I want to thank you, Mr. Chairman, for assembling this panel.

Mr. Burke, I want to thank you and your association for bringing together as many as you could on short notice and having a meeting. The five of you this morning all spoke to the point of the local companies. I assume all 39 of you meeting yesterday were all pretty much in agreement on that?

Mr. BURKE. Yes. So you will understand the process, the testimony I have presented to the committee was distributed, it was mailed out to all 54 jurisdictions. Thirty-nine of them had representatives here yesterday. They all had an opportunity to look at it. Then our communications committee met last night. Except for the several slight modifications they made in my opening remarks, that is the position of NARUC.

I might add also that I will transmit to you at the conclusion of this hearing the several resolutions that the NARUC Communications Committee has passed last night which we would like to have included in the record.

Mr. WIRTH. Without objection that will be included in the record after Mr. Bliley's questions.

Mr. BLILEY. Last week I asked Mr. Brown about this point, and asked him who was going to furnish the directory to the local customer. If they were going to take the Yellow Pages, were they, A.T. & T., going to supply directories to the local customers. He very quickly responded no, that would be the responsility of the local company. Then I asked him how they would pay for it. And he said they would be entitled to make a charge.

After the meeting, reflecting on that point, one of the most difficult and frustrating things that any of us experience is going to a strange place, going to a pay phone booth and trying to find a phone book. Would you precisely tell me how the local company would keep a book in a local booth if it is one that is sold? It is hard enough now when there is no direct charge made for it.

Mr. **Burke**. I am with you. I think that the Yellow Pages have become a basic part of basic telephone service. We are told by advertising all across the country, let your fingers walk through the Yellow Pages, look to that first.

Frankly, my personal view of the Yellow Pages, and I am speaking personally, is that the revenues ought to be from advertising, and that the books themselves should remain as a noncharged item so that we do have them available to the American people.

Mr. **Bliley**. Another line very quickly, not to trespass on the other Members' time. In asking us, as you did, to use the access charge to protect current contribution, is there a practical way to do that? Is it in a national formula or should it be left to each PUC to do that?

Mr. **Burke**. All right. On this there is some difference of opinion. Many of the States feel that the access charges should be set by the individual States. In response to prior questions I do believe there should be national guidelines. I think we need a joint board on this. I don't want to see the United States totally Balkanized. I think there are some local cost factors that have to be considered, but I remain, maybe not a new federalist but an old federalist, and I believe we do have to have national standards and a National Joint Board on that subject.

Mr. **Bliley**. I have just been handed a note, Mr. Burke, that says that under the settlement, pay phones would to go the national company. Is that your understanding?

Mr. **Burke**. That is our understanding, yes. That is a fact. We may not understand it, but that is the fact.

Mr. **Bliley**. Who would service them?

Mr. **Burke**. I haven't—at this point I must confess I haven't got the foggiest notion. Maybe one of my colleagues can tell us.

Mr. **Schneidewind**. It wouldn't be the local exchange carrier. That we do know. It would be some other entity.

Mr. **Bliley**. I see. Is there a rationale for that? Can you enlighten us?

Mr. **Burke**. I think you are asking the wrong witnesses.

Mr. **Schneidewind**. The wrong people.

Mr. **Bliley**. I think we are singing to the choir.

Thank you very much, Mr. Burke. You have been most helpful as have the other members.

[The following information was received for the record:]

Modification of Settlement Agreement

Be it resolved that NARUC seek modification of the settlement agreement that will:

(1) Require, prior to transfer of any assets, that A.T. & T. spin off the operating companies as corporate entities with all the assets and liabilities that they now have; (2) empower the State commissions to set exchange access charges; and (3) require that after divestiture the BOC's and any potential purchaser negotiate the division of assets subject to approval by the affected State commissions and the FCC.

Other Resolutions

1. The NARUC should file a motion in the A.T. & T. antitrust case, suggesting that the Federal/State Joint Board be utilized as a special master with respect to the settlement agreement.

(2) The NARUC should further move the Court to establish a comment period after A.T. & T.'s submission of the implementation plan.

3. With respect to H. R. 5158, the NARUC should advocate a majority of State commissioners on the joint board proposed in that bill.

Mr. WIRTH. Thank you, Mr. Bliley.

Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman.

Charles Brown, chairman of A.T. & T., last week testified before the committee that telephone rates would rise 10 percent per year for the next 5 years, averaging a dollar a year on the overall rate of the telephone bills.

Could you help put that in perspective for us? Why is there such a great differentiation between what you people predict and what he is predicting? Where do you see the great differences between your analysis of the problem and why he is so optimistic about the ability to continue affordable rates at the local level?

Mr. SCHNEIDEWIND. It depends on which, of course, either the Senate bill or the A.T. & T. settlement, you are talking about. But they do have some aspects which we believe would absolutely mandate very, very large and very rapid rate increases.

Let me go through some of those. The first for the people of Michigan is that both the settlement and Senate bill 898 contemplate, either immediately or after a 4-year period, transfer of Yellow Pages to either the deregulated entity or, in the case of the settlement agreement, out of the local exchange carrier. That is an increase of about $2.10 per month per Michigan basic phone customer.

We now, even with the Computer II inquiry results from the FCC, have the right to continue to offer the customer premises equipment now in place. However, S. 898 and the A.T. & T. settlement would take that away from us. Well the loss of the profits from the lease of that equipment by our most recently available data from Michigan Bell mean that customers' bills would go up $1.27 a month.

Similarly, the change in this procedure of assessing access or charges for using the local network for long distance calls, there would be two impacts. The first impact is that assets necessary to make those calls and finish the calls would be transfered from a local company to a deregulated entity. That means that that is an integral part of the formula for setting those charges, how many assets are involved. So when you transfer assets, you lose revenue.

The second factor is that both the settlement agreement and Senate bill 898, while they skirt around the issue, essentially come out for what they call cost based access charges. Now the position of A.T. & T. before FCC is that cost based charges would result in the loss of interstate toll revenue of about $2.53 per customer in Michigan. That is plus the loss of the plant to make them. And from intrastate toll, $1.86.

In other words, they would have us use a different formula for assessing charges and they would decrease the amount of assets that are used to make those calls. And the next effect in Michigan would be about, over $4 per customer per month. Now how they can say that these cost impacts don't exist is really beyond me, because we have the numbers, we have been working with local phone companies, letting them look at the numbers and challenging them and discuss them.

We still come out with the fact that the Senate bill at a bare minimum would double rates without inflation, but once all the contemplated actions take effect, and that the settlement agreement would most certainly more than double these rates and probably triple them.

Mr. **HIPP**. I would add one thing. I think it is possible that Mr. Brown may be standing on a very narrow point, that the settlement agreement itself would only add 10 percent. That all of these other things are being caused by Computer II. And so, which is ongoing, regardless of the settlement agreement. So it made that distinction.

Mr. **MARKEY**. Thank you.

Mr. **BRYSON**. Congressman Markey, I might add something. I agree entirely. I think the analysis for each State varies slightly from State to State. We have provided several analyses, one to Congressman Matsui, who was a member of this subcommittee, a year ago, in September 1980, that was very detailed and went through each of these items.

The largest single impact in California, and there are many, as Commissioner Schneidewind set out, was the reduced contribution from interstate phone calls to the maintenance of the local network. Just let me give you one number on that, and that is a number that is from A.T. & T. Again, many of these numbers are from A.T. & T. We have used them because we believe them to be conservative since these are directions in which A.T. & T. seeks to move. Let me just read this.

Figures furnished to us by A.T. & T. indicate that, nationwide, local telephone service rates in 1990 would need to be roughly $40 billion higher as a result of a change in this formula for contribution by long distance providers to the local network. $40 billion higher than currently. This increase compares with the total local service revenues of about $23 billion in 1979. That is, the increase alone is vastly larger than the level of revenues in 1979.

Those impacts are formidable and we have assessed them against this analysis of A.T. & T. that shows how many people would lose phone service if that occurs. It is a huge number.

Mr. **BURKE**. Representative, in New England——

Mr. **MARKEY**. Could I ask you, does the House bill take care of any of your concerns on this subject?

Mr. **BURKE**. The House bill does take care of many of our concerns. I just want to add one comment. That is, that in the New England Telephone & Telegraph area which services our constituents and is my area, I think that the same comments apply. I would subscribe to what Commissioner Hipp said. It is not just the settlement. It is the fact that in case after case A.T. & T. or telephone company representatives have testified to the fact that the long lines have subsidized very heavily basic telephone service. Insofar as those long line revenues are taken away, there have been telephone company officials talking about the doubling and trebling of rates.

Mr. **WIRTH**. Mr. Markey.

Mr. **MARKEY**. Mr. Schneidewind, did you want to respond to that?

Mr. **SCHNEIDEWIND**. Well, H.R. 5158 certainly, in the area of letting State regulators decide how to dispose of the embedded customer premises equipment, that is to say, to either depreciate it or auction it, is far better, is better than either 898 or the settlement. In the area of receiving fair market value for other assets, it is much better.

It partly addresses the loss of this access charge, or settlements income by creating a national telecommunications fund which could be supplemented by surcharges on the access charges levied. We feel that is an area that needs improvement to assure us that the income from access charges is equivalent to the existing income from what we call the settlements process.

Mr. MARKEY. How would you accomplish that?

Mr. SCHNEIDEWIND. There are several ways to do it. First of all we have suggested that State regulators be allowed to set the access charges for any incoming calls to a local exchange. In the absence of that, to create a joint board of Federal and State regulators with dominant State membership which would set that charge with the written requirement that the starting point would be a level of revenues that is roughly equivalent to what we are receiving now, and recognition, then, that it is true that over a period of time, as competing technology evolves, it may enable bypass of this local network, in which case all regulators would have to start lowering that access charge.

But the key point is, this and other changes would be done gradually. We would not jump off the cliff. We would do it over a period of time. And if the technology did not evolve, we would not have to do it.

Mr. WIRTH. Would the gentleman yield?

Mr. MARKEY. I would be glad to yield.

Mr. WIRTH. Those transitional measures are ones we have all worked on to try to make sure that as part of this market moves to the competitive environment, and part of it remains in the monopoly environment, that that transition is not a flash-cut deregulation.

If the gentleman might yield further, on the subject of the access charges—the point you just made, Mr. Scheidewind—we have looked carefully at how we should go about administering that access charge. Under 5158 it is, as you have pointed out, administerd by the joint board, comprised of three FCC commissioners and two State commissioners.

I think all of you have said this morning that there can be problems when we are dealing with a lot of diverse geographical areas, 1,500 phone companies, 3,000 miles and so on. What kinds of problems would exist if, as you were suggesting, access charges were administered by State PUC's under broad national guidelines set by the FCC? You would not want 50 different telecommunications policies in the United States. So to have that broad guideline set by the FCC and then administered by the State commissions, would that resolve both of your concerns of having a national policy, but still being responsive to local needs?

Mr. SCHNEIDEWIND. I think that is a very wise proposal and one that combines the strength of both the local body, which is their sensitivity to individual conditions, and the need for some overall framework. I would add that there would be, I think, a requirement that in the instructions, the legislative mandate to the FCC, however, that there be a mandate that any cost increases that they might push for as part of their national policymaking role would be limited.

In other words, we would not want to see them with the authority to determine how high the magnitude of the general impact as we saw fit. We would want to have some restraint on any policy changes, or the monetary impact of those.

My colleague from California, President Bryson, has suggested in his testimony that the general guideline for changes in access charges or separations procedures be that in no one year can changes result in more than a certain percentage impact on local phone rates. That may not be the specific answer. But I would urge you that, in setting up a framework of both Federal and State participation, that you constrain the actions of the FCC in such a way that they could not produce a rapid and precipitous change in the total revenue picture.

Mr. **Burke**. I subscribe basically to what Commissioner Schneidewind just said. I would think, however, that the national guidelines might properly be set not by the FCC, but by a Federal-State joint board.

Mr. **Wirth**. I understand that would be the mechanism you would use. The TJB can set those guidelines.

I thank the gentleman for yielding. This is a point of very real concern as to how that access charge is administered. It has to be legislated in order to make sure that the jurisdictions are clear.

The suggestions this morning have been very, very helpful. I thank the gentlemen.

Mr. **Bryson**. I wonder if I might follow up briefly on the question you have put, because I think your suggestion of States setting the access charges under national guidelines is an excellent one. There are two problem areas. One is the transition. In the transition we think that Congress should, itself, specify very carefully the standards for introduction of changed formulas for provision of local cost, or for payment by long-distance providers through the access charge toward the costs of the local network.

So we do urge in our testimony that, rather than leaving it to some relatively vague formula change that is only one component of major increases in local rates, that Congress specify to the joint board or whatever other body it is directing, that the transition is going from one formula to another that would result in this doubling of rates be taken by steps that we recommend would not allow that one formula alone to result in an increase in basic phone rates of more than 5 percent a year. You could pick any other percentage.

Second, on the question of leaving the ultimate question of access charges to the State jurisdictions, I think there is great rationale in that this can be done in a way that avoids a problem with the national network. What we are talking about is essentially a local cost question. That is, how much cost is imposed on the local network by the necessity to have facilities that receive or terminate long distance calls. Those costs will vary significantly from State to State and exchange to exchange.

We think the kind of analysis is required there that is typical to State commissions, highly specific, regionally specific, locally crafted cost analysis. I think it would be appropriate to leave that question to the State commissions under national guidance.

Mr. **Wirth**. Thank you, Mr. Bryson.

Mr. **Markey**. Thank you.

Can we talk about, if we could just briefly, long distance, that component here, and the very real fear that you have of the loss of that subsidy which goes to local rates.

What should we do with long distance? A later witness, Pete Loux, chairman of the State Corporation Commission of the State of Kansas, recommends that we set up a separate subsidiary for the long distance, for long lines. Do you agree with that? Is that a good idea? Is that something that, despite the size of it, might be something we should consider as a way of reducing cross-subsidization?

Mr. **Cresse**. Well, Mr. Chairman, my understanding is that it is a separate subsidiary now. And I think what you have to recognize is that you are trying to establish national policy to encourage competition in that particular area. One of the areas.

And the methodology, the structure to assure that there is no cross-subsidy from that long distance service has to be established, whether it is in a separate subsidiary. It seems that is the easiest way to do it. It is big enough to be able to not impose any tremendous additional cost by keeping it as a separate subsidiary. And you have to continue to regulate that for a long period of time because there is, in fact, not competition everywhere in this country.

Mr. **Markey**. William Baxter and Charles Brown both testified before us that there is competition. Despite the fact that there is 97 percent share by long lines, that you do not look at market share but market power.

Clearly, MCI and Sprint and the others have that. So for all intents and purposes there is. Do you and other people in your field, do the people in your State have the accessibility to alter and meet long distance that Mr. Baxter and Mr. Brown would have us believe?

Mr. **Burke**. It is starting to develop. Obviously there has been some cream skimming because the high volume routes are there. It is starting to happen in New England now as you know, although we were a little behind some of the other areas, except for a few specific routes. I frankly feel it is an area with great potential for competition. There is some now and it will be developing. I think with appropriate exchange access fees, and access fees into the system as we have described them today, that that is one aspect of both the legislation as you have proposed it, that will not be greatly affected by the A.T. & T. settlement.

I am speaking personally. But I think that is legitimate competition, Mr. Representative. I think we can live with that.

Mr. **Markey**. Does it exist today though? Is there competition?

Mr. **Burke**. There is some. Obviously when you say 96 percent, it is a very limited competition. But compared to what it was 5 or 6 years ago, compared to the fact that now, a number of entities are moving into the area, and the changes of technology that are developing, yes, I do on all the reading I have seen foresee growing competition.

I think if we are going to have it, let's see how it works. I think you are going to have to watch it closely and we are going to have to watch it closely. But I do not think overly restricting this option at this point will give potential competition a fair chance.

Mr. **Markey**. Mr. Bryson, in Woodland, Calif., do the people have access to alternative long distance services?

Mr. **Bryson**. I would be very surprised if they did. There are many areas, most areas in the State outside the large metropolitan areas do not have those alternatives. They are coming in slowly.

Mr. **Markey**. Is there still a monopoly?

Mr. **Bryson**. There is unquestionably.

Mr. **Markey**. Do you agree with that, Mr. Cresse?

Mr. **Cresse**. Yes, sir.

Mr. **Markey**. Do you, Mr.——

Mr. **Cresse**. You make a long distance from Tallahassee to Jacksonville, you have to use A.T. & T. long lines. My testimony says the same if you make one from Sopchoppy to Two Egg, Fla., small, two large communities west of Tallahassee.

Mr. **Markey**. Mr. Hipp?

Mr. **Hipp**. It is a monopoly in the great majority of areas in North Carolina. There are three cities that have it available if you have a large account of total expenses.

Mr. **Markey**. You have three cities out of your entire State?

Mr. **Hipp**. That is my present information, yes.

Mr. **Markey**. Mr. Schneidewind?

Mr. **Schneidewind**. I think Congressman, one of the things a lot of us are excited about in your bill and others, you have it in your power to make sure in the future it would not be a monopoly. That could be done by setting up a system of fair, nondiscriminatory access charges and access to the network.

What we are urging, we do want that aspect of the legislation very much because then we can have competition. And I think only through nondiscriminatory access, which we do not have now. So now it is true, there is what amounts to a monpoly but only if you act, only if you set up a system of nondiscriminatory rates and access to the local network will we have the benefits of competition throughout our States.

Mr. **Markey**. Thank you, Mr. Chairman.

Mr. **Wirth**. Thank you, Mr. Markey.

Mr. Broyhill.

Mr. **Broyhill**. Thank you. You know, I have been involved in this issue for a number of years. Sometimes I think I am just about to grasp it, then I get into a hearing like this, and then I realize that I am still at the basics. I am not sure that I understand what everyone is saying.

One of the concerns that the panel, as well as everyone around the country is expressing is what is going to happen to the cost of telephone service. That is what I hear from this panel today.

I am not sure I am hearing the same thing from everyone, not only here, but from other witnesses we have had before us, as well as information we have seen in the news media.

One thing of course is the impact that the consent decree might have on the cost of telephone service. Now I do agree with what some of the estimates that have been presented by this panel, that if certain things happen, that the price of telephone service is going to go up.

But is this a direct result of the implementing of the consent decree? As I understand the consent decree, inside wiring would continue to provide a subsidy to local rates. Is that correct?

Mr. **Burke**. For a period of time.

Mr. **Broyhill**. Right. Yellow pages would continue to provide a subsidy for 4 years.

Mr. **Burke**. I am sorry.

Mr. **Broyhill**. And also you would take out, of course, your terminal equipment.

Mr. **Bryson**. Congressman, on the inside wiring point, with the possible correction of others and their States, inside wiring has not and does not provide a subsidy to local rates I think in the most fundamental sense. Inside wiring in fact is a very substantial cost burden for the local operating companies. It is the health of those local operating companies that will determine both the quality and cost of local service.

Inside wiring traditionally has been a relatively large capital cost item which has——

Mr. **Broyhill**. I understand that. But the point I am getting at is what is in the consent decree that would impact on local rates other than taking the terminal equipment from the local operating company?

Mr. **Bryson**. The most fundamental thing is what follows in the implementation of the consent decree. The consent decree is very generally framed. It leaves it with A.T. & T., working with the Justice Department, to work out all the details. Our concern——

Mr. **Broyhill**. I was told the Justice Department is not going to be involved in this. It will be up to the courts.

Mr. **Bryson**. Mr. Baxter told us yesterday that the Justice Department will be monitoring through the next 6 months all phases of development of the consent decree, to make its own comments to the courts. We have sought, all of us, to intervene before the courts. We have been denied.

Mr. **Broyhill**. I am not trying to have a debate here. All I am trying to do is get some facts. The facts are as to what is the impact of the consent decree on the cost of telephone service. And in my calculations, it will be minimal compared to the impact that passage of either 898 or 5158 would have on the cost of telephone service. That is the point I am getting at.

Mr. **Burke**. Until we get——

Mr. **Broyhill**. I understand the gentlemen here are saying they oppose going from SPF to SLU. H.R. 5158 as I understand it would have us going from SPF to SLU.

Mr. **Cresse**. Let me see if I can respond to that, sir, explicitly. The proposed settlement takes out yellow pages, period.

Mr. **Broyhill**. Four years down the road.

Mr. **Cresse**. No, sir, that is Senate bill 898 takes it out 4 years down the road. H.R. 5158 says, if you take it, you pay fair market value for it. Of course that would be negotiated from now until I do not know when, what is fair market value.

So there is a big difference between the approaches taken in those areas. The customer premises equipment, big difference taken in those bills. For example, your bill provides an opportunity for existing customers to purchase that equipment. Makes a big difference, as opposed to the settlement. It takes it right out of local contributions immediately.

It does not phase it out over a period of time. There is no opportunity for the existing customers who have, where that equipment is installed, to purchase it. Now A.T. & T. has testified it is their intent, and it may change from time to time—they have testified before our commission through Southern Bell spokesmen that it was their intent not to sell equipment to their customers but to always lease it.

Never make it available at purchase price but to always lease it. Your bill addresses that issue and does not put that many customers in an unregulated market overnight, which the settlement does.

Mr. SCHNEIDEWIND. May I add to that?

Mr. BROYHILL. I understand that, but nobody has addressed this issue I brought up. As I understand what you have just said a few minutes ago is that you were for H.R. 5158 but you opposed going from SPF to SLU. Maybe I misunderstood you.

Mr. SCHNEIDEWIND. Congressman, first of all, I would like to elaborate. We have read the settlement agreement for instance to immediately deregulate inside wiring, which means it would be removed from the settlement process, which is a loss of income. We have interpreted the settlement agreement to transfer a sizable number of assets from local exchange carriers to some other entity, which results in loss of income.

We have interpreted it to call for a cost based formula for assessing charges. That would have a drastic loss of income. The difference today between 5158 and the other approaches is a couple-fold. First, it does provide a more gradual transition than the others, but contains within it the germ of an idea of a surcharge which would be put into a national fund which would help support basic and affordable local service.

However, we have said here today we are not in favor of that provision as it stands now and think it should be changed.

Mr. BROYHILL. That is what I am trying to get at, is that I am not either.

Mr. SCHNEIDEWIND. Good. I share your view.

Mr. BROYHILL. I am just concerned that what we are doing here is setting up a temporary program. At the end of that 5-year period the rates are going to shoot up again.

Mr. SCHNEIDEWIND. We all share the view I believe that there should be a more permanent approach that it does not lose before technology requires that SPF-type charge.

Mr. WIRTH. If the gentleman would yield, to clarify where we are and the settlement versus H.R. 5158 as I understand it. Under the settlement and H.R. 5158, for long distance calling you will eventually go to a cost basis from SPF to SLU, and as we had done last year in H.R. 6121. Unlike the constant decree, though, H.R. 5158 provides for a National Telecommunications Fund that would provide a subsidy to cushion the impact of moving to a cost based charge, as well as significant subsidies that remain ad infinitum for those hard to serve areas, those rural areas—the bottom of the

Grand Canyon, et cetra. All of the very difficult, spread out and very expensive places are maintained at a subsidy level.

So, there are possible parallels between the settlement and H.R. 5158 in terms of going from SPF to SLU, though under my legislation we would move to SLU much more gradually. However, the consent decree provides for no subsidy mechanism for local rates. You have to define what that access charge is going to be and who administers it as we have previously discussed. Then after you have gone to SLU over that period of time there remains under H.R. 5158 that long term ad infinitum subsidy for rural and other hard to serve areas.

Mr. **Broyhill**. Mr. Chairman, if I could reclaim my time, I am very familiar with that because we worked that out last year. But, I understand these gentlemen are saying they are expressing concern about this and are asking us to consider amendments to change it. I am not convinced in my mind that we ought to sit here with our feet planted in cement. Perhaps we ought to revise it and listen to their concerns. As I understand what they are saying, there will still be the impact down the road of substantial increases in telephone rates as a result, of the language in H.R. 5158, if it would pass. Is that what you are saying? Or am I misstating it?

Mr. **Cresse**. Mr. Broyhill?

Mr. **Broyhill**. I want to understand it.

Mr. **Cresse**. Let me talk about the access to the local network and whether you are going to have SPF to SLU or whatever the charge is going to be. With competition, sir, it seems to me what you are really doing is pricing access to the local network in a manner that would benefit the vast body of ratepayers. If you price that too high, you will increase their costs because the local network will be by-passed. If you price it too low, then you are going to increase local charges. It seems to me if we recognize that as we start off, and do not set a framework or a time where you are going to have SLU or SPF or what have you, you then provide the opportunity to those that are responsible for regulation to maintain that goal of universal service to, in effect, be cognizant of what is going to happen when you make those decisions. I think the states can do that under the supervision of the FCC. Let them set the policy.

Mr. **Broyhill**. Is that not what the Senate bill did, and the House bill is the opposite of that?

Mr. **Cresse**. Well, sir, I do not know. Maybe that is one of the things that needs to be clarified.

Mr. **Broyhill**. That is what I said. I am getting confused here. It seems I am hearing two or three different things from this group. I understand that is what you are saying, but I understand the Senate bill would accomplish what you are saying, and the House bill would drive us towards, from SPF to SLU within a set period of time.

Mr. **Bryson**. Congressman, I think that isn't accurate.

Mr. **Broyhill**. That isn't correct?

Mr. **Bryson**. The Senate bill looks to a joint board to determine the movement from SPF to SLU if that is the ultimate formula and to deal with the transitional problem of increases in local rates. The House bill likewise looks to a joint board. The configuration of the joint boards in the Senate bill and House bill are different. We think the House bill is preferable in that respect. Several of us have suggested some other modest procedural changes dealing with the transition. I think we all recognize that there will be a transition, and most of our comments have gone to procedural means of dealing with that transition in a way that has minimal impacts on basic local rates.

Mr. **Broyhill**. That is, I think, where I am agreeing with the gentleman from Florida. I am not convinced that the House bill provides that kind of flexibility to deal with it.

Mr. **Schneidewind**. I think the suggestion just made by Chairman Wirth of perhaps a different relationship between the States and the Federal authorities in the administration on the one hand and formulation of broad guidelines on the other indicates an approach that, from what I can tell, we believe would be far preferable to what we have been seeing.

Mr. **Broyhill**. That would certainly get my support.

Mr. **Schneidewind**. That seems to offer——

Mr. **Broyhill**. The States should have a larger role.

Mr. **Burke**. I think we should stress in relation to your original question relative to the A.T. & T. settlement, that until the plan is further developed, and until we get a better determination of how assets are going to be evaluated, we can't fully calculate the costs of that measure.

Mr. **Broyhill**. That brings up a point. Are you going to be involved; are your States going to be involved in evaluating those assets that are within your States?

Mr. **Schneidewind**. We certainly hope to be and we are deeply fearful that the process set up in the settlement would absolutely cut us out of that.

Mr. **Burke**. It is our position that we want to be involved. We think it would be absolutely incredible not to have us involved.

Mr. **Broyhill**. Are you prepared to take on that job?

Mr. **Schneidewind**. We do that today. We regulate the rate base of the operating companies today. So, it is not a new burden. It is one that, believe me, we are fully prepared to continue.

Mr. **Broyhill**. You have the data base and the information in order to carry out that responsibility?

Mr. **Schneidewind**. We are doing that now.

Mr. **Bryson**. Congressman, one point on that. A fundamental concern that we have with the consent decree is that it puts A.T. & T. in a position to determine the details that would govern the shape of the telecommunications industry in the future at a time when A.T. & T.'s economic interest in the future lies not with local service, not with a high quality and affordable local network, but rather with the unregulated businesses which they are looking to, long distance service, fancy telephone equipment and possibly getting into data transmission and information processing.

As long as A.T. & T. owns the local companies to whom all the local consumers are hitched for their service, the local companies will be unable to speak up independently in this asset evaluation and transfer process.

Frankly, my feeling is that the local companies know more than the public utility commissions or the FCC or anyone else about just what the worth of their existing line of business is and about the assets which under the antitrust decree they will have to give up. And we ought to put those local companies in an independent position to themselves negotiate with A.T. & T. to offer to the State commissions and FCC a blueprint for the future.

It is critically important in my judgment that we unshackle the local companies and make them our allies in the process of insuring affordable local rates.

Mr. BROYHILL. Well, it is my understanding that the court will of course make the ultimate decision, and the court will base that decision on what is presented to it together with the comments, information, suggestions and other data, which is furnished by interested parties such as yourselves.

Mr. BRYSON. We think the decision is too important to leave to the court in the context of an antitrust settlement.

Mr. BROYHILL. Are you saying that the Congress should pass legislation to stop this settlement?

Mr. BRYSON. Not stop it. There are some steps, most of those steps are outlined in H.R. 5158. This is an excellent piece of legislation. I don't mean to create any doubts on that. I do not think the rest of us do. This has been very carefully crafted, balanced, fair legislation. All the comments we are making today, and I think this is the view of all of us, are suggestions for some modifications we think would represent improvements, and suggestions further in the light of the antitrust settlement; H.R. 5158 was drafted in its current form prior to that settlement. That settlement to us requires some change in the legislation. But this is very good legislation. We think it is critical that Congress set the policy and not leave it to the courts in the antitrust settlement.

Mr. BROYHILL. I do appreciate that, and I do think the Congress should act also. I look forward to working with your group and your staff as we try to make modifications to H.R. 5158 in order to accomplish the same goals that we all want. That is affordable, universal telephone service at affordable rates.

As I pointed out, the only reservation I have in looking at H.R. 5158, as the panel and Chairman well know, is whether or not that really accomplishes the goal we thought we were going to accomplish.

Mr. CRESSE. Congressman, I might suggest we don't think we want you to stop that settlement, we just want you to amend it before it is complete.

Mr. BURKE. And it would not be a court decision as we understand it. The court has the option of approving or rejecting the settlement.

So, it would not be a decision of the court. It would be the settlement as presently constituted, or as amended by the parties.

Mr. WIRTH. If I might at this point add two items of clarification on the discussion. One, an area in which I think Mr. Broyhill and I agree is the jurisdiction and the responsibilities of the State PUC's relating to the access charge. First of all, to take it on the Senate side, S. 898 just says that the FCC will establish and carry that out. The House bill is very detailed, saying that the access charge is terribly important. H.R. 5158 details exactly what the access charge is going to consider and how it is considered. What we are discussing now is that given the broad national policy set up in the legislation and then interpreted by the transitional joint board—three members of the FCC and two State commissioners—then the next step is how the access charge is implemented. And the discussion we had about an hour ago is that that in turn should be delegated to the PUC's to be carried out. We establish in legislation what the national policy is. We do not leave it to the FCC blanket authority to carry it out. Then that moves down the line, and the implementation—which is what you all have been suggesting—can be done by the State PUC's within those national guidelines and within that national policy set by the Congress. Is that correct?

[Chorus of "correct" from witnesses.]

Mr. **Wirth**. The second point of clarification relates to this valuation of assets question. You all are in a good position to evaluate assets for the operating companies. But it may be that operating companies don't have very many assets for you to evaluate. You have nothing at all to do under the settlement with what belongs to the operating company and what belongs to the parent, correct?

Mr. **Cresse**. But, Congressman, that is what we are asking you to address.

Mr. **Wirth**. I understand. I just want to make sure we all understand what it is we are talking about here. First of all, under the settlement A.T. & T. makes the decision. Then that is approved by the court. A.T. & T. makes the decision as to what belongs to the parent company and what belongs to the local company. You all have nothing to do with that whatsoever, correct?

Mr. **Burke**. We are seeking to change that however.

Mr. **Wirth**. I understand that. At this point you have nothing to do with that?

Mr. **Bryson**. Absolutely correct.

Mr. **Wirth**. One would presumably wonder how much expertise the court has in the valuation of assets, which is what you all do for a living. Yet the court determines what belongs to the parent and what belongs to the local company.

After that determination is made, then there is the possibility that you can become involved with the local operating company in evaluating the assets that have already been determined to be left with that local operating company.

Mr. **Bryson**. That is too late.

Mr. **Wirth**. There is no place at all where your expertise developed over the last 60 years is involved with the question of who owns what. Your expertise is not involved with that question of what belongs to the parent and what belongs to the local company, correct?

Mr. **Schneidewind**. We have been told it is highly likely that many of these valuable resources, not just what is transferred but how much value it is given, we have been told many will be transferred at book cost which is——

Mr. **Wirth**. There is a very real question of what is transferred and at what value an item is transferred. Going back to the question of whose interest is represented, what do the Bell operating companies have to say about what assets belong in the parent and what belongs in the local company?

Mr. **Bryson**. That is the most fundamental problem, Congressman. People in the local operating companies who see their future side to those companies are desperately concerned in the future about the health of those companies. As long as they are owned by A.T. & T.——

Mr. **Wirth**. Let's understand what is in the settlement at this point. At this point, A.T. & T. determines what assets go where.

Second, the local operating companies do not have anything to do with that. Is there a potential of different kinds of interests that might be reflected by an A.T. & T. executive and local operating company executive?

Mr. **Bryson**. Not only a potential. It is an absolute fact.

Mr. **Wirth**. At this point while all of this is going on, who is paying the salary of the local operating company executive?

Mr. **Schneidewind**. A.T. & T.

Mr. **Wirth**. So where in this mix is it possible for the local operating companies to make their voice heard effectively?

Mr. **Bryson**. There is no current avenue.

Mr. **Wirth**. I thank you.

Mr. Rinaldo.

Mr. **Rinaldo**. Thank you very much, Mr. Chairman. I certainly want to welcome the panel. My main concern, representing a moderate-income district, is that local telephone rates be kept at reasonable, affordable levels. At prior hearings, we heard varying testimony concerning the amount of increases that would take place at the local level.

Now in order to keep local rates within reasonable levels, there are a number of things that could be done. I just want to bounce one suggestion off you for your comments.

We could require, for example, higher payments to local telephone companies by OCC's such as MCI and Southern Pacific, who connect their long distance facilities to the local telephone company. My understanding, correct me if I am wrong, is that OCC's now pay only about half of what is paid by the traditional long distance carriers.

Do you believe that increased interconnection charges by OCC's to the local telephone company is desirable?

Mr. **Burke**. Yes.

Mr. **Schneidewind**. Right now what we have to do though as one of the goals of this legislation is to insure that the type of access they receive to the local network is of a comparable quality and ease, if you will, as the access that is currently given to A.T. & T. Once that is assured, once both the type and quality of access is on an equal basis as A.T. & T., there certainly is no reason they should not be charged the same amount as A.T. & T. is charging.

Today that is not true. But we have taken a position that we think that access should be equal and we should have guidance in terms of assuring that all carriers have the same quality and type of access.

Mr. **Bryson**. One point on that, Congressman. I think the fee should be equal for equal quality of service. Right now there is not equal access or quality but that is a relatively small part of the picture here that amounts to a projection of very large rate increases. That is, it is true that MCI and Sprint and others are coming in, and coming in relatively fast in some areas. Nonetheless, we are talking about a very tiny fraction of the revenues of A.T. & T.

So a change in that formula alone does not weigh in heavily at all in comparison with a number of factors we have mentioned here today.

Mr. RINALDO. Well, there is no change currently provided for in the legislation before this committee. But if we had the change that I propose in the legislation, how do you feel it would affect local rates? Would it help to keep the rates at more reasonable affordable levels?

Mr. BRYSON. My understanding, and I may be wrong, is that what the bill contemplates is equal access charges. I am not familiar with the specific language.

Mr. RINALDO. I believe you are wrong there.

Mr. BRYSON. I doubt any of us have that quantified. But it is a desirable step to have equal access charges for equal quality of access. The contribution to maintenance of low basic rates under current conditions, where the others have a relatively small market share, would not be great. It might be significant 10 years from now.

Mr. RINALDO. In conjunction with that, what other steps or suggestions would you recommend be taken to keep local rates at or about the same level, with the exception of built-in increases that occur as a result of normal inflationary pressures?

Mr. HIPP. Well, Congressman, I think you would have—to really keep them at the same level, you would have to reverse substantially some of the steps being taken now. The access charge, if the bill would extend the 5-year protection on a permanent basis, I think that is the biggest loss of revenue that will impact the local rate, is the loss in the present separations and settlements revenue by going to an access charge.

Now the access charge could equal the present revenue if the bill would extend the 5-year period where the States have a role in the fixing of the access charge. It is just the amount they will pay. As long as everyone pays that amount, then it is a fair chance for all competition to use the access to the local exchange.

But there are other things that are driving the rates up, too. Customer premise equipment. The depreciation rates. The Yellow Pages and the inside wiring shifts. They are all driving the rates up. You would have to provide the same type of protection against all of those different factors that are driving the rates up or will drive them up over various periods of time.

Mr. RINALDO. In other words, what you are saying is that you feel we should legislate in each of those areas?

Mr. HIPP. Well, I think you are providing some protection to an initial period in each of those areas, if it could be extended more than this temporary transition joint board, if it could be a permanent joint board that has the same continuing jurisdiction to protect those local rates beyond the 3- and 5-year periods that are provided.

Mr. RINALDO. Does anyone else have any other suggestions or comments? I have one other question. My understanding is that under the agreement the local telephone companies that A.T. & T. must divest will be confined to offering traditional local telephone service. They will be forbidden from offering terminal equipment, long distance services, enhanced services and all other competitive activities.

Do you folks believe it is good public policy to restrict the kinds of business that local telephone companies can engage in? And if you believe that is good public policy, why is it good public policy?

Mr. **Burke**. Personally, I do not think it is good public policy. That is a broadly based answer to your question. I think that if they are restrained from getting involved in a number of these activities, Mr. Congressman, it will eventually very seriously impact on their financial viability.

Mr. **Rinaldo**. So then the limitations that I have just mentioned will be harmful to their financial viability and, in effect, will create or act as a stimulus for increased rates for local calls?

Mr. **Burke**. That is why some of us are very concerned in relation to the settlement that there be a continuing, assuming the approval of the settlement in some form, that there be a continuing process of review as to the settlement. And because we feel that if some areas of self-sufficiency, I might put it, are not opened up to the local operating companies, they are going to be seriously impacted.

Mr. **Bryson**. Congressman, one additional idea on your question of steps that might be taken to hold down basic local rates. There is a new and I think important factor that has not been analyzed previously because it grows out of the consent decree. That is the market domination of telephone switching equipment, a huge cost item in the telephone system, by Western Electric.

The consent decree contemplates that the local companies, as you know, would be divested. The local companies would in the future have the ability to purchase from Western Electric, the A.T. & T. affiliate, or any other company. One of the things that I think this bill has been very, very good on and this committee has analyzed carefully is the extent of current market dominance in some of these potentially competitive areas with the committee's understanding that even areas that are unquestionably potentially competitive may not yet be competitive today.

We are concerned that with the consent decree, Bell companies practically speaking, after the divestiture, would be able to turn only to Western Electric for their equipment because the large switches are made almost exclusively by Western Electric. No one previously has seen the opportunity to get into that market; 90.5 percent of the Bell System requirements for this kind of equipment are supplied by Western Electric now. There is no significant competition there. Consequently, we have some recommendations in our testimony at page 25 for interim regulation, say for a 5-year period, that would set some limits on Western Electric pricing for sales to the divested local companies, to constrain price increases in that equipment during a period——

Mr. **Rinaldo**. Excuse me, do you not think——

Mr. **Bryson**. Over a period where there would effectively be a monopoly.

Mr. **Rinaldo**. Do you not think that over a period of time as divestiture takes place, market conditions will automatically cause this to occur?

Mr. **Bryson**. I do think that. I am concerned only about the period in which this Western Electric market dominance is such that as a practical matter there are not options for the operating companies in these purchases. During that period I think you would have, only because of this transition, the ability on the part of Western Electric to extract monopoly profits because there are no other providers.

I think that would be erased in a relatively short period of time. We would recommend 5 years, maybe it can be done in fewer years. The committee has looked at this kind of problem in several areas very, very well. This is a new problem that arises because of the antitrust settlement.

Mr. **Cresse**. I do not see any reason why the customers of an existing Bell operating company should by the settlement of an antitrust suit be denied the same type of service as the customers would receive in the General Telephone Co. area within the State of Florida. And I view that from the customer's viewpoint.

With that settlement, you will have 2,800,000 customers that cannot get anything except local service, period. But you can go to the Tampa/St. Petersburg area and there are about a million customers over there dealing with Gen Tel of Florida, a sub of GTE, that can continue to look to their telephone company to receive exactly the same service they are receiving today for a period of time as provided under this bill.

I think, sir, that proposed settlement in fact places a tremendous burden on the local operating companies both from a financial standpoint and places an extreme inconvenience on the customers to the local operating companies, and you ought to stop it.

Mr. **Rinaldo**. That is why I asked you for your suggestions that are primarily aimed at correcting the financial burden that we know is going to be incurred by the local operating companies.

Mr. **Schneidewind**. From our standpoint H.R. 5158 in the area of insuring provision of local service is far and away the best of all the approaches. It does provide for use of existing equipment until fully depreciated. It does allow for the provision of inside wiring for 5 years. That even can be extended.

But we think perhaps a little further in that area to just continue to allow the basic telephone, at the very least, to be provided and serviced by the local exchange carrier is necessary because, for instance, in the Upper Peninsula of Michigan these people do get snowed in for a week at a time. And they live in such a low-density area in many cases that you could not economically justify local maintenance forces. However, with our regulatory setup now we can provide that service to these people.

For their livelihood and their safety it is just absolutley critical.

Mr. **Rinaldo**. Thank you. I have no further questions, Mr. Chairman.

Mr. **Wirth**. Thank you, Mr. Rinaldo. I believe Mr. Luken still has questions he wanted to ask of the panel.

Mr. Jacobs, perhaps you might go and see if Mr. Luken will come back for those questions. I want to recognize the distinguished chairman of the full committee, the gentleman from Michigan, Mr. Dingell.

Mr. **Dingell**. Mr. Chairman, I thank you.

Gentlemen, we are happy to welcome you to the committee and thank you for coming. We know you have come considerable distances. We are keenly aware of the concerns that you have here this morning.

Mr. CHAIRMAN. I ask unanimous consent to be permitted to insert into the record at the appropriate place a brief statement on this matter.

Mr. WIRTH. Without objection, it will be included in the record.

STATEMENT OF HON. JOHN D. DINGELL

Mr. Chairman, I commend you for holding these hearings on the impacts on telephone ratepayers of the proposed settlement of the Justice Department's antitrust case against AT&T and legislative safeguards necessary or appropriate to protect ratepayer interests. I also want to commend you, Mr. Chairman, for your leadership in seeking consensus legislation establishing a modern national telecommunications policy that brings the fruits of the electronic revolution to the marketplace while ensuring that essential communications services remain available to all Americans at affordable rates.

The agreement submitted by the Justice Department and AT&T to Judge Greene for his approval portends far-reaching changes in today's telecommunications environment and represents a dramatic new development in the debate on national telecommunication's policy. The proposed settlement is a rough blueprint for the future structure of the telephone industry and the terms on which AT&T will compete in unregulated lines of business. However, many important questions must be answered about its impacts on the cost and quality of telephone service available to the public, on the viability of the companies that will provide that service, and on the future competitive environment in the telecommunications and data processing industries.

These issues will be illuminated in the Tunney Act proceedings to be conducted by Judge Greene. These proceedings will afford interested members of the public an opporunity to speak to the full range of impacts the settlement may have and to address the many aspects of the settlement in need of clarification. With the benefit of public input, the Court will determine whether the proposed settlement is in the public interest.

The Congress also has an obligation to evaluate the settlement to determine both its specific effects and its relevance in the broader context of national telecommunications policy. We must take full account of the broad public interest at stake in the debate on national telecommunications policy, as well as the many individual interests involved. These do not always coincide. To legislate wisely, we must have a clear understanding of the settlements' impacts on the multitude of interests affected.

I am hopeful that the Subcommittee's hearings will bring into sharp focus those issues which must be addressed to protect the interests of the local telephone ratepayer. Paramount in this category of issues are questions relating to the existence and establishment of authority and mechanisms for the imposition of charges for access to the local networks at levels that will preserve and enhance universal service at affordable rates. Other critical questions pertain to the treatment of a number of AT&T's assets and revenue streams for purposes of rate base regulation and additional revenue-generating activities that the operating companies may pursue. How these issues are resolved will have multi-billion dollar impacts on the cost and quality of telephone service. Accordingly, I welcome a thorough exploration of the issues raised by the settlement in conjunction with our legislative deliberations to enable the Congress to determine how the public interest may be best served in light of this dramatic new development.

Again, Mr. Chairman, I commend you for holding these important hearings. I welcome our distinguished witnesses, and most especially the distinguished Members of the Michigan Public Service Commission.

Mr. DINGELL. Thank you, Mr. Chairman.

Gentlemen, you have indicated you have concerns about State public service commissions having sufficient authority under existing law or the settlement to protect ratepayers from adverse effects of the settlement. Is that correct?

Mr. **Burke**. Yes.

Mr. **Cresse**. Yes

Mr. **Schneidewind**. Yes.

Mr. **Hipp**. Yes.

Mr. **Bryson**. Yes.

Mr. **Dingell**. It is my understand that the A.T. & T. settlement would not permit a consumer in Michigan or in any of the service areas of the Bell operating companies to call the local telephone company and ask it to install equipment in his home or place of business. Is that correct?

Mr. **Schneidewind**. That is correct.

Mr. **Dingell**. Is that something you think should be corrected in legislation?

Mr. **Schneidewind**. Very definitely. Mr. Dingell, I think you are keenly aware that, in our State, there are many areas where not only is the installation of equipment so widely dispersed that there are not local suppliers who would be able to do that, but just as critical, the maintenance of that equipment is not such in terms of the rural areas, the Upper Peninsula, the northern part of the Lower Peninsula, where the density is not so great as to justify with just strict economic criteria local maintenance forces in residence who can quickly act in disasters and provide the service on equipment that is necessary.

Mr. **Dingell**. I think you make an excellent point. Let me ask you this. Are the State public service commissions and NARUC submitting comments on the settlement to the court under the Tunney Act procedures?

Mr. **Burke**. Yes, we moved to intervene in the first instance. All motions to intervene were denied without prejudice. Now we are preparing comments. We also seek to make comments after the full plan is submitted to Justice.

Mr. **Dingell**. Do you feel that the terms of the settlement can be sufficiently clarified in Tunney Act proceedings?

Mr. **Schneidewind**. No. If there is one area we are perhaps more disturbed about than any other, it is the prospect of having to provide comments before the entire plan, which those comments should logically address, is even before the judge or before us in one whole piece. We have met with Justice Department officials who have said they might let us see parts of it before it is complete. We have no assurance that when that 60 days is over, we have even seen the plan we should comment on.

Mr. **Dingell**. It appears to me that the settlement as proposed by the parties is hardly more than a bare bones outline that will require significant expansion and changes.

Your concern is that you are being compelled to comment at this particular time on a proposal in need of significant amplification. Is that correct?

Mr. **Schneidewind**. That is correct.

Mr. **Dingell**. It is your view, then, that at the time of the approval of the settlement, under ATT's submission, and Justice Department's submission and agreements for implementation of the settlement, you may be denied an opportunity to make adequate submissions with regard to matters of concern to you. Is that what you are telling us?

Mr. **Burke**. Of course our position is that we should be allowed to intervene, not just comment.

Mr. **Dingell**. To actually intervene in the proceeding? I am not sure whether that is timely under Federal rules. Have you explored that?

Mr. **Schneidewind**. Yes, in Michigan through Attorney General Kelly we have already filed that motion. It has been denied.

Mr. **Dingell**. Denied by whom?

Mr. **Burke**. Judge Greene, without prejudice.

Mr. **Dingell**. So it can be renewed?

Mr. **Schneidewind**. It may be.

Mr. **Dingell**. That is not appealable as I understand it; is that correct?

Mr. **Bryson**. Not at this time. And very difficult to appeal effectively at any time.

Mr. **Schneidewind**. That is under review.

Mr. **Dingell**. There are two questions that I detect are of great concern to you. One is the ability of the Bell Operating Companies to provide equipment and service immediately after divestiture and the other is the ability of the local operating company to exist as a viable entity over the longer term. Is that correct?

Mr. **Schneidewind**. That is correct.

Mr. **Dingell**. Would you give us your comments on these points please?

Mr. **Schneidewind**. I will provide you with testimony which details that impact. To summarize it briefly, the settlement agreement absolutely prohibits a local exchange carrier from either installing or servicing equipment. So there would be no local force in many rural areas we believe to install or service telephone equipment in someone's home.

The second aspect is that the settlement agreement transfers out of the operating companies so many valuable assets and so much rate base that is used to compute access charges or settlement charges as they are now known, that the revenue shortfall as a result of these activities would increase rates more than 100 percent, and we think probably 200 percent is a better estimate.

Mr. **Dingell**. So you have the two problems then with regard to the local telephone rates. The first is the problem of transfer of assets out of the rate base of the local service companies. Then there is the additional problem of the changing situation as regards revenues paid to the local companies for costs attributable to long distance calls. Is that correct?

Mr. **Schneidewind**. Income from those.

Mr. **Dingell**. Have you made presentations to the courts or do you intend to make presentation to the court under the Tunney Act on these two points?

Mr. **Schneidewind**. Yes; first we have taken two steps. One to assert our right to make the Tunney presentation. But the first and the one taken in concert as of last night with the entire NARUC organization is to say that the best way to accomplish this split would be, first, to spin off the existing companies as they stand now.

For instance, Michigan Bell with all its assets, all its prerogatives, all its royalties, all its staff. Then and only then should we have assets transferred back to A.T. & T. because then we would have an adversary process in which the employees of Michigan Bell would not be getting their paycheck from the same people that they had to deal with in terms of the valuation and type of assets that were transferred.

So we as an entire national organization have viewed as a critical first step in the settlement that the operating companies be spun off as free-standing entities, and then and only then do we begin to value and determine what amounts of assets are to be transferred.

Mr. DINGELL. Then it is your view that will not be adequately represented under the interests of the operating companies in the settlement?

Mr. SCHNEIDEWIND. We feel there is no recognition because their economic viability would be so weakened that they would be left in the position of having to ask local regulators for huge rate increases which would not increase the value or quality of service to the customers one bit.

That is an untenable situation.

Mr. DINGELL. All right.

Now if you were not permitted to make appropriate submissions on the Tunney Act in the separate second phase that you have alluded to earlier after the Department of Justice and A.T. & T. have made the submissions, is it your view that you can under the Federal rules and statutes make submission, or will you need statutory relief on that particular point?

Mr. BURKE. We may very well need statutory relief. That is a matter under review at this point. I do not want to make a final comment.

Mr. BRYSON. We have asked for the opportunity to comment subsequently after the A.T. & T. plan is filed.

Mr. DINGELL. I am aware of that.

Mr. BRYSON. That may or may not be granted. It is not part of the Tunney Act. The court would have to establish a special procedure. That may be within the court's discretion. I still want to make the point that I think we all feel that is too limited a forum. That is, Judge Green will be instructed to make a decision under the antitrust laws of the United States.

There are considerations here that in our judgment are in addition to the narrow focus that the court would have under the antitrust laws. For example, the antitrust laws say nothing about maintenance of affordable basic local rates and high quality basic local service. In addition, as you pointed out, the local operating companies that have that responsibility and to whom the local customers are linked will have no opportunity, unless they are divested immediately, to comment themselves.

So we will in our judgment be too far down the road with too little scope for comment even if the court proceedings do provide us room, which they do not currently.

Mr. DINGELL. Gentlemen, with regard to the division of revenues between the local telephone companies, and the long lines and other long distance carriers will you have authority after divestiture to obtain sufficient revenues through charges you could levy on long distance carriers for tying into the local companies to protect local taxpayers?

Mr. **Schneidewind**. No, we will not.

Mr. **Dingell**. Why?

Mr. **Schneidewind**. For two separate reasons which go to the way these charges are calculated. The first element of the calculation is the amount of assets that are used in providing interconnection to the long distance. The vast majority or a lot of those assets would be transferred from that local exchange carrier to A.T. & T. by the agreement so we would lose that element of the charge.

Mr. **Dingell**. Would you please amplify that statement?

Mr. **Schneidewind**. It takes a certain number of assets to complete the call, if you will, that is made on an interstate basis. Many of those assets would be taken away from the local exchange carrier and given to A.T. & T. So the base on which the charge is allocated for rendering the service would be shrunk, and therefore the revenue would shrink.

The second aspect of that is the formula itself used to determine how much money. In other words, the formula that is applied to the assets. That in the settlement agreement they use the word cost will be a factor rather than what is now a cost plus system.

So that moving the charge formula down to a cost basis would deprive us of another substantial chunk of revenue. The FCC according to the settlement would be left in the position to determine that formula. They are going toward cost. So with those two aspects, the local exchange carrier would lose a substantial amount of revenue.

In the case of Michigan Bell's customers, we calculate those two factors would cost the average customer, basic service charge customer, about $4.50 per month in increases.

Mr. **Dingell**. You are sure then, that you do not have authority to deal with this problem adequately?

Mr. **Schneidewind**. That is correct.

Mr. **Dingell**. I gather all of you gentlemen as witnesses would concur generally with Mr. Schneidewind's comment, is that correct?

Mr. **Burke**. Yes, we decided to let the chairman of the Michigan Commission respond to the distinguished representative from Michigan, but we all concur with his comments.

Mr. **Dingell**. Gentlemen, thank you.

Mr. Chairman, thank you.

Mr. **Wirth**. Before we close could you all give us a sense of what you think the time table is going to be of the Tunney Act provision and the time table set by the settlement? How would that and the legislative time table in the ideal world would come together?

Mr. **Burke**. Let me lead off by saying that obviously, there is a 6-month period in which the full plan must be submitted to Judge Green, and for comment. We think there will be—so that that is the outside period in which the full plan will be in place.

We are hoping the plan will be submitted on a more accelerated basis. We think that that is in the national interest and in the interest of everyone.

Six months from that date in January gets us down into the month of July. I think that subsequently, if we are allowed to make comments after the plan is submitted, that could be 30 to 60 days, which could get us into early September. I would submit that it is going to be necessary to continue the legislative process, and not wait for that to be completed.

That is an overall view of our best guess of what is going to happen.

Mr. **Wirth**. Does anyone else wish to comment?

Mr. **Bryson**. There is a little ambiguity on the exact schedule as I understand it. I have been provided a note that indicates that the 60 days of the Tunney Act procedure would not begin to run until the Department of Justice provides notice of the settlement in the Federal Register. That would be done next week.

Further, under the settlement, the 6 months for A.T. & T. to file the plan would not begin until the settlement is approved. So that is stretched out. The subcommittee has indicated previously it hopes to have legislation ready for passage out of the House of Representatives this spring, March or April, if I recall correctly.

That seems to me a suitable time table. The urgency of this legislation has been increased considerably by this settlement process. I think it would not be in the national interest if the legislation were delayed at all beyond that.

Mr. **Burke**. As one said, we do not all have the same answers. I would like to know the source of the date of when the 6 months is going to run, because it is not what I recall from Mr. Baxter or Mr. Carr.

If there is some later information on that, I think it would be helpful to all of us, John.

Mr. **Bryson**. All right. If I am incorrect on that, I will file a change in the record, but people behind me are whispering that I am right.

Mr. **Wirth**. It is our understanding, Mr. Burke, that 6 months is a minimum period in that timeframe. Gentlemen, I thank you very much.

Mr. **Markey**. Mr. Chairman, could I ask just in light of that exchange that occurred between Mr. Bryson and Mr. Burke, would it be possible for your organization, working in an intensive but short time frame to be able to put together the amendments in legislative form that you would like to see this committee adopt as a remedy for the deficiencies in the settlement.

You each have suggestions individually in your testimony but it does not seem to be a comprehensive position as yet adopted. If it would be possible I think it would be very helpful to all of us if you would submit, with the imprimatur of your association, the position that you believe the committee ought to take in protecting the local ratepayers and at the same time preserve competition.

Mr. **Burke**. We would be happy to do so. Our communications committee and executive committee will be meeting in Washington during the last week in February. We will try to follow up on that suggestion.

Mr. **Markey**. The time table, though, may be brief.

Mr. **Burke**. Yes.

Mr. **Cresse**. Congressman, we have already submitted to the staff the amendments that would implement suggestions which came in our prefiled testimony.

Mr. **Markey**. Thank you.

Mr. **Burke**. Mr. Chairman, may I just submit for the record the Public Service Commission of the State of North Dakota had some comments which it wishes to submit.

Mr. **Wirth**. Fine, without objection the record will remain open for that statement, and other statements that you or your colleagues would like to include in the record.

[Testimony resumes on p. 272.]

[The statement from Public Service Commission of the State of North Dakota follows:]

Public Service Commission
State of North Dakota
Capitol Building
Bismarck, North Dakota 58505
(701) 224-2400

Commissioners
Richard A. Elkin, President
Bruce Hagen
Leo M. Reinbold,
Secretary, Janet Sauter

January 21, 1982

The Honorable Timothy E. Wirth
Subcommittee on Telecommunications, Consumer
  Protection, and Finance
United States House of Representatives
Washington, D.C. 20515

RE: North Dakota Public Service Commission comments on H. R. 5158, a bill proposing the Telecommunications Act of 1981, introduced December 10, 1981.

Dear Representative Wirth:

The North Dakota Public Service Commission regulates all intrastate telephone service in North Dakota. Since North Dakota is one of the most rural states in the United States, we are extremely concerned about the possible impact of House Bill 5158 and Senate Bill 898. We are equally concerned about the impact of the proposed AT&T antitrust settlement upon our state and sparsely populated rural areas like our state. Furthermore, we have followed the policy changes of the Federal Communications Commission (FCC). We know that all of these events are reactions to the technological changes that have been going on for some time in our country--indeed, in the world.

Under current joint federal-state jurisdiction, the telecommunications industry flourished and simultaneously benefited millions of Americans with high quality "universal service" unmatched and envied by the rest of the world. Under current exclusive state jurisdiction, North Dakota's exchange and intrastate interexchange service is among the best in the United States, but the existing high standards of universal service did not develop in a vacuum. Instead, these standards grew out of responsive and accessible federal and state regulation.

Because of technological changes, we see the need for a new federal and state regulatory environment which promotes competition. However, we believe that such an environment must "balance" regulation and competition. The "balancing" of regulation and competition must be honestly and realistically oriented toward the goal of providing "universal telecommunications service at reasonable and affordable charges."

In the most densely populated states, the goal of "universal service" will probably be best served by a "balance" that will shift toward competition. Conversely, in sparsely populated states, like North Dakota, the universal service goal will likely be best served by a "balance" that favors regulation. Of course, the best balance will be dependent upon the current level of technology and the prevailing needs of the ratepayers to be served.

Because North Dakota is not densely populated, we believe our area will be one of the last places where "adequate" interchange carrier competition will significantly contribute to providing "universal service at reasonable and affordable charges." While we willingly accept our place at the bottom rung of the competitive ladder, we are most distressed that H.R. 5158 will gut state commission jurisdiction to regulate or deregulate a substantial portion of the telecommunications services in North Dakota.

Under H.R. 5158, we are all but stripped of any power which could be used to significantly shape our own telecommunications future. Under H.R. 5158, the State of North Dakota, through its Public Service Commission, will not be allowed to decide for itself whether "adequate competition" exists which will provide "universal service" for North Dakota ratepayers at "reasonable" and "affordable" charges. Under H.R. 5158, we will have lost the power to determine what is economically and technologically palatable for our own citizens. Instead, the main course of meeting our economic and technologic telecommunications needs will be charted by a remote, insensitive and unresponsive Washington, D.C.-based federal bureaucracy--the FCC.

Surely, locally accessible state jurisdiction is more responsive to questions of what is "reasonable", "practical" and "adequate" for providing "universal service" to local ratepayers. What may be good for the metropolitan "northeast corridor" may not be good for rural North Dakota. Arguably, and contrary to H.R. 5158, state commissions should retain, if not acquire, increased jurisdiction. Contrary to H.R. 5158, state commissions should, at minimum, have the exclusive jurisdiction to: (1) classify intrastate interexchange and exchange carriers as regulated or deregulated, (2) establish intrastate interexchange and exchange tariffs, (3) value the assets of regulated carriers, (4) determine exchange area boundaries, and most importantly (5) set nondiscriminatory exchange area access charges. Finally, any transitional federal-state board must be dominated by state commission membership and the board's decisions must not be reviewable by the FCC.

We agree that your Committee's bill, H.R. 5158 is a significant improvement over S. 898. However, H.R. 5158 will not allow state commissions to play an "integral role" in meeting the goal of "universal service." (Wirth, Introduction Statement, at 2.) Instead, H.R. 5158 is a symptom of the deregulation mania sweeping Congress. Unfortunately, a casualty of this epidemic is serious consideration of traditional and effectively utilized state jurisdiction. The legislation itself is sprinkled with platitudinous purposes as follows:

> to make available to all the people of the United States efficient nationwide and worldwide tele-communications at reasonable and affordable charges
>
> ....
>
> to encourage cooperation between the Federal Government and the States in regulating telecommunications carriers, to recognize the appropriate jurisdictional authority of the States, and to utilize effectively the regulatory expertise of state commissions. H.R. 5158 pp 2-3.

In short, we believe H.R. 5158 may result in large and unnecessary rate increases thereby jeopardizing existing "universal service." The legislation demonstrates just how removed the Congress is from residential, small business and rural ratepayers. This legislation seeks to turn the rift between local ratepayers and federal regulators into an abyss. This legislation creates the abyss by stripping the states of their traditional responsive powers and making a federal bureaucracy larger, more powerful and less responsive.

The cost of telephone service is already very high for many of our people as it is also equally high for people across the land. We believe Congress and the Administration should be careful with major changes in our communications law. This country should remain committed to universal service at the most reasonable cost possible, but determined largely by state commissions.

The major problems with H.R. 5158 are:

> H.R. 5158 will preempt state commission jurisdiction to classify intrastate interexchange carriers as dominant, regulated or deregulated carriers.
>
> H.R. 5158 will preempt state jurisdiction to regulate intrastate interexchange carriers and services.
>
> H.R. 5158 will preempt state jurisdiction to value the assets of exchange carriers prior to asset transfer.
>
> H.R. 5158 will preempt state jurisdiction to set exchange area access charges.
>
> H.R. 5158 will reduce revenues contributed by interexchange carriers to exchange carriers. Bell estimates basic rates will double or triple as a result.

H.R. 5158 will preempt state jurisdiction to create optional and extended calling plans that cross over into other exchange areas.

H.R. 5158 will set up a five-year transitional joint board dominated by FCC members. Upon termination, the board's functions would be turned over to the FCC.

H.R. 5158 will divert directory advertising revenue away from local exchange operations at a cost to each North Dakota ratepayer of over $23 per year.

We understand the monumental task which this legislation has posed. We understand the good intent of your Subcommittee in trying to resolve complex telecommunications problems. We applaud your efforts to move the telecommunications industry into the competitive arena. However, we have serious reservations about the specified "appropriate jurisdictional authority of the states." Thus, we hope that your Subcommittee will consider the above general comments along with the enclosed specific comments for incorporation into the proposed legislation.

Respectfully,

Richard Elkin

Richard A. Elkin, Chairman

Bruce Hagen

Bruce Hagen, Commissioner

Leo M. Reinbold

Leo M. Reinbold, Commissioner

Attachment

COMMENTS ON H.R. 5158

SUBMITTED BY THE NORTH DAKOTA PUBLIC SERVICE COMMISSION

January 21, 1982

Part A - Regulatory Authority of Commission

Scope of Regulatory Authority, Classification of Carriers and Services, Review of Classifications, Determination of Adequacy of Alternative Facilities, Interconnection.

In general, the proposed scope of regulatory authority of the FCC is entirely too pervasive, while state commission jurisdiction is all but wiped-out. If the FCC is to wield as much power as H.R. 5158 specifies, then we believe that beyond a five-year "transition period" it would be a short step toward total FCC preemption over all telecommunications jurisdiction. Sec. 211 pp 7-8.

We see no reason why state commissions should be prohibited from classifying intrastate interexchange carriers. After all, one of the purposes of H.R. 5158 is to "utilize effectively the regulatory expertise of state commissions". It is our judgment that locally accessible state commissions are better able to determine the classification an intrastate interexchange carrier should have. A state commission is better able to "balance" the local impacts of deregulation against regulation and simultaneously consider the cliched goal of "universal service" at "reasonable and affordable charges".

There is no evidence to suggest that state commissions are not as qualified as the FCC to determine whether intrastate interexchange service should be regulated because "there are not adequate alternative facilities." Sec. 212(d) p 10, line 17 and p 11, lines 1-2. Similarly there is no evidence to suggest that state commissions are not qualified to determine whether intrastate interexchange service should be deregulated because unaffiliated deregulated carriers and resellers are providing service which is "comparable in quality, economic cost, and geographic range" and "there are sufficient offerings" of such service. Sec. 212(d) p 11, lines 10-16.

In determining that there is an "adequate alternative facility" a state commission is just as capable as the FCC in finding "sufficient capacity to ensure competitive pricing in the absence of regulation". Sec. 213, p 12, lines 15-16.

There is no evidence that state commissions would not be as effective as the FCC in enforcement of interconnection requirements stated in Section 214. Similarly the state commissions could approve "the manner, rates, terms, and conditions for the provision of interconnection to regulated intrastate interexchange and exchange services or facilities." Sec. 214(b), p 13, lines 10-12.

On the other hand, should Congress find that states lack necessary expertise and better judgment for intrastate interexchange carrier classification, adequate alternative facility determination and interconnection enforcement, then there should be a provision that mandates full delegation of such jurisdiction if and when a state satisfies reasonable and specific statutory standards, e.g. adequate staff and statutory and regulatory language in place.

Finally, if Congress finds that under no circumstances could states be made capable of exercising such jurisdiction, then the FCC should have the duty, rather than simple discretion, to hold hearings upon state commission petition for reclassification, and interconnection enforcement. See Sec. 212(a)(5) p 9, lines 6-9, and Sec. 214(c)(2) p 13, lines 16-17.

Part B - Interexchange Transmission

Establishment of Carrier Requirements, Requirements Applicable to Regulated Carriers' Tariffs, Requirements Applicable to Dominant Carriers, Enhanced Services.

There is no evidence that the states are incapable or cannot be made capable of judging the "level of competition in the markets involved" when prescribing different requirements ... for different subcategories of regulated carriers ... different transmission facilities or services or ... various combinations of carriers, facilities, and services" for intrastate interexchange carriers. Sec. 221(a) pp 13-14. State commissions are better able to specify "conditions governing the provision of any [regulated intrastate] interexchange service as may be necessary to ensure" high quality services at reasonable and affordable rates. Sec. 221, p 14, lines 8-10.

There is no evidence that state commissions are incapable or cannot be made capable of enforcement of the requirements of Section 222 with regard to intrastate interexchange carriers. pp 14-16. In permitting a termination or suspension of service, state commissions are as capable as the FCC in the determination of whether there are "adequate alternative facilities." Sec. 222(d), pp 15-16.

Notice of termination or suspension of service by an intrastate interexchange carrier to a state commission serves little purpose other than to notify the state commission that it may petition the FCC to exercise its discretion to review the classification through a public hearing. Sec. 222(d), pp 15-16. At minimum, instead of exercising discretion to hold such a hearing, upon state request, the FCC should be mandated to hold a hearing in the locality affected by the suspension or termination.

At minimum, state commissions should also be given written notice when "any person ... intends to offer or terminate resale of any [intrastate] interexchange service". Sec. 222(e) p 16, lines 8-9.

State commissions are capable of enforcement of Section 223 with regard to regulated intrastate interexchange carriers. pp 17-18. The state commission is capable of determining the standards of a "reasonable request" for service. Sec. 223(a) p 17, line 4. Likewise, the state commission is capable of determining whether tariffs

> (A) provide customers with as wide a range of qualities, options, capabilities, prices, and geographic range as is practical; and
>
> (B) permit customers to obtain such access to each of the components and segments of services as is practical, Sec. 223(b)(1) p 17, lines 5-11. [Emphasis added]

Should Congress remain convinced that a state commission is incapable and cannot be made capable of determining the reasonableness of intrastate interexchange tariffs, then upon request by the relevant state commission the carrier should be required to file an appropriate modification with the FCC. Sec. 223(b)(3), p 17, lines 21-23. In this manner, federal jurisdiction will be more responsive to local needs.

While state commissions should retain jurisdiction over intrastate interexchange tariffs, should Congress remain bent on emasculation of state authority, public notice and opportunity for public comment on a tariff filing by an intrastate interexchange carrier should be more than simple publication in the Federal Register. Sec. 226(b)(2)(A) p 19, lines 14-17. Notice should be sent by certified mail to the pertinent state commission and periodically published in official newspapers located in the area affected or sent by mail to affected exchange subscribers in a "bill stuffer".

When a tariff is filed, upon state commission request the FCC should be required to hold a hearing in the area of affected ratepayers. Sec. 226(d) pp 20-21.

State commissions are also capable of regulating the provision of enhanced services by regulated intrastate, interexchange and exchange carriers. Sec. 228 pp 22-23. State commissions are capable of making sure that regulated carriers do not file tariffs for any regulated service which includes costs associated with the provision of enhanced services or facilities. Sec. 228(c) p 22, lines 21-25.

Notwithstanding, the proposed H.R. 5158 language and our suggested changes, it should be clear we believe that intrastate interexchange ratemaking is best left with the states. Because North Dakota is not densely populated, we believe our area will be one of the last places where "adequate" interexchange carrier competition will significantly contribute to providing "universal service at reasonable and affordable charges." Surely, locally accessible state jurisdiction is more responsive to questions of what is "reasonable", "practical", and "adequate" for local ratepayers.

Part C - Exchange Transmission

Offering of Service, Exchange Areas, Protection of Competitive Conditions in Dependent Markets, Contributions for Universal Service, National Telecommunications Fund, Cooperation With State Commissions.

Contrary to H.R. 5158, exchange area designation should be a matter exclusively delegated to the state commissions and should not be reviewable by the transitional joint board or any other federal agency. State commissions are better informed of local conditions which characterize an area as "serving common social, economic, and other similar purposes." Since exchange area boundary designation is a local matter, a state commission judgment should be subject only to state court review rather than federal agency review. Similarly, state commissions should not be locked in to exchange area boundaries as of January 1, 1982, or any other specific date. As changes in social and economic geography take place, state commissions should be able to change exchange area boundaries. Sec. 231(a)(b) and (c)(1) p 23, lines 7-23.

In establishing exchange area boundaries, the goal of promoting competition in interexchange service is reasonable. Sec 231 (c)(1) p 23, lines 20-23. However, the goal of promoting competition should be balanced against the goal of providing "universal service at reasonable and affordable charges." What is deemed "reasonable, affordable and universal service" and simultaneously promotion of competition, may be quite different in different parts of the country. What may be good for the metrolpolitan "northeast corridor" may not be good for rural North Dakota. Designation of exchange area boundaries may have a great impact in meeting these laudable goals. Although H.R. 5158 does not so state, we believe that exchange areas may include more than one regulated exchange carrier.

Given the general standard of a common social-economic area, it appears that requiring exchange areas to "substantially" coincide with standard metropolitan statistical areas, except in "densely populated states" may preclude the benefit of better informed and responsive state commission discretion. Sec. 231(c) and (d), pp 23-24.

Since we believe that state commissions can in fact be "utilized effectively" to meet the goals of providing "universal service at reasonable and affordable charges" while relying on competitive forces to the maximum extent possible, we also believe that state commissions are capable of enforcing competitive conditions in markets "which depend upon exchange facilities and services or which may be used in conjunction with such facilities and services." Sec. 232(a) p 25, lines 1-3.

Contrary to H.R. 5158, state commissions should have exclusive authority to set nondiscriminatory exchange access charges. Sec. 232(b) p 25-26. This is an area that will affect the attainment of "universal service at reasonable and affordable charges." Since the "universal service" goal is best attained through state commission regulation, it follows that access charge jurisdiction is best left exclusively to the states. The FCC or transitional joint board may propose formulas as guidelines for the states, but the states should not be bound by such formulas.

Not only should state commissions be given the exclusive jurisdiction to set all exchange area access charges, access charges should be allowed, which recover more than the costs caused by interexchange traffic. Sec. 233(a)(b)(c)(d)(e) pp 26-30. This would give state commissions a means to meet the goal of universal service while exercising some discretion as to the movement from value-of-service rates toward totally cost-based rates. Without such discretion, H.R. 5158 will limit revenues contributed by interexchange carriers to amounts which cover costs. Consequently, H.R. 5158 may result in doubling or tripling of basic rates.

If Congress finds that state commissions generally are not capable of setting access charges such authority should be conditionally delegated to state commissions for all exchange areas within a state with no more than 100,000 main stations and equivalents. However, contrary to H.R. 5158 such delegation should be conditional only on state commission staff capabilities and statutory and regulatory authority. State commissions should not be bound by transitional joint board rules and procedures for determining jurisdictional allocation of plant and operating expenses. However, the joint board may suggest guidelines. Sec. 233(f) pp 30-31.

The access fee transition period as stated in Sec. 233(g) appears to be six years, but the transitional joint board which is charged with oversight is to exist for only five years. Sec. 273(i) p 76, lines 9-11. Thus, this transitional board function and the board's life-span do not coincide.

Collections from all interexchange carriers for a National Telecommunications Fund is reasonable. However, proceeds from such a fund should be collected and distributed in the context of state commission retention of jurisdiction over exchange access charges which may recover more than the costs caused by interexchange traffic. Sec. 234 pp 32-36.

Whether or not the fund is enacted as proposed, rather than a five-year life-span the fund should continue indefinitely; i.e., until eliminated or changed by Congressional action. In this manner Congress would be forced to assess the impacts of fund termination. Although payments from the fund would be subject to audit and adjustment to ensure that incentives are not removed for efficient exchange operation, this power is another example of federal encroachment on exclusive state authority to regulate local exchanges. Because acceptance of payments from the fund could be considered acceptance of "federal grant funds", a whole host of federal procurement regulations may be tied to the spending of the "federal dollars." These procurement regulations would put the recipient exchange carriers into management strait-jackets.

No doubt H.R. 5158 will end current state jurisdiction over optional and extended exchange area calling plans. In North Dakota the Bell System serves 205,976 main stations or approximately 73 percent of all North Dakota subscribers. Approximately 200,000 of Bell's North Dakota mainstations are under Extended Area Service while 1,431 main stations are under Community Interest Calling Plans. Thus, North Dakotans are heavily dependent on extended exchange area calling plans which will be terminated under H.R. 5158.

Without significant change, H.R. 5158 will radically preempt state jurisdiction over exchange transmission service. The state commissions will be formally intact but functionally gutted shells. To say that under H.R. 5158 there will be "effective utilization" of the state commissions to regulate exchange carriers to meet the goal of "universal service at reasonable and affordable charges using competition to the maximum extent possible" is truly fallacious.

Part D - Telecommunications Equipment

Technical Standards, Terminal Equipment,
Inside Wiring, Telecommunications Facilities.

Proposed provisions regarding terminal equipment and inside wiring appear adequate.

State commissions are capable or may be made capable of enforcing nondiscriminatory procurement policies on regulated intrastate interexchange and exchange carriers. Sec. 243 pp 39-42.

Under H. R. 5158 the FCC retains authority to establish and enforce technical standards for facilities and services to support the national defense and emergency preparedness. Sec. 241(a) p 37, lines 1-16. Since significant military installations are located in North Dakota, this authority may have substantial impact on North Dakota ratepayers. Such impact may result if local exchange and interexchange carriers are forced to "harden" their facilities for military purposes and recover the costs from local ratepayers. Unless such costs are recovered nationally, extraordinary burdens may unfairly fall on local civilian ratepayers. Sec. 262(f) p 56 lines 17-18. In short, the proposed legislation does not express the method of cost recovery for meeting "national defense" standards with regard to network facilities.

Part G - Protection of Ratepayers and Employees in Transition to Competitive Marketplace

Declaration of Purposes, Treatment of Terminal Equipment And Inside Wiring During Transition, Transitional Joint Board, Treatment of Certain Interexchange Service During Transition, Employee Protection.

We believe the proposed treatment of terminal equipment and inside wiring during transition is reasonable. Sec. 272 pp 66-70.

We believe state commission participation in the transitional joint board is inadequate. Sec. 273(c) p 71, lines 6-11. Given the power of the board to "[value] assets transferred by regulated carriers to separate subsidiaries" and the duty to "ensur[e] equitable economic treatment of users of exchange service and interexchange service," and the impact the exercise of these joint board functions will have on local ratepayers, the board membership must be dominated by state commission members. Sec. 273 pp 70-76.

By letter of October 20, 1981, to the House Subcommittee on Telecommunications, Consumer Protection and Finance, the NARUC expressed its concern that a transitional joint board which sets access charges and performs asset evaluations should be composed of three FCC commissioners and four state commissioners. Should state commissions lose valuation and access charge jurisdiction as proposed, we agree with the NARUC position. It is difficult to comprehend how the proposed board can reasonably be expected to balance what are apparently conflicting goals of competition and "universal service" without a membership dominated by those who are accessible and responsive to local ratepayer needs. Clearly, if "effective utilization" of state commission expertise is to be something more than mere rhetoric, then the board must be dominated by state commissioners. Sec. 273 pp 70-76.

Additionally, joint board valuations and access charge determinations should not be subject to FCC review. Sec. 273(f)(3) p 74, lines 18-22. Rather, review should only be vested in the federal courts. In this manner, the joint board would not be reduced to the level of an administrative law judge who is subject to reversal and remand by the FCC.

Delegation of valuation authority to state commissions should be mandated "in the case of any regulated exchange carriers which together with an affiliates include less than 500,000 main stations and equivalent stations" [in an exchange area]. Sec. 273 (f)(5) p 75, lines 16-22. In this way, state commissions will be "utilized effectively."

Under H.R. 5158, state jurisdiction to consider directory advertising revenue for ratemaking purposes is removed. Sec. 211(b) p 7, lines 17-24 and Sec. 273(f) pp 73-75. As stated by NARUC on S.898, a position this we continue to support, "the value of directory advertising is linked to telephone service and is directly related to the number of subscribers within an exchange area." Because of the "linkage" the telephone company has no effective competition in this form of advertising. Thus directory advertising revenues should be used for the benefit of subscribers.

Nationally, an estimated $1.881 billion in revenue is realized by the Bell System alone from directory advertising. For all telephone companies and cooperatives operating in North Dakota for the year ended December 31, 1980, $6,351,690 gross revenue (before taxes) would be necessary to replace the loss of directory advertising revenue for ratemaking purposes. The $6,351,690 gross revenue requirement would have increased a subscriber's bill about $1.93 per month or $23.16 per year if directory advertising revenue had not been applied in ratemaking. This revenue is currently available for local service, but it will be lost to those states, including North Dakota, now using yellow page revenue in ratemaking, if the bill is enacted without change.

Notwithstanding, the pending antitrust settlement, we believe the "spun-off" AT&T operating companies should be legislatively encouraged to reduce local revenue requirements by selling lists of numbers to the highest bidder, or alternatively, by operating a directory advertising business as a competitor against AT&T.

Mr. WIRTH. Again, we greatly appreciate your time and attention and careful work on this issue. We look forward to working with you on the resolution of these problems.

Perhaps if there are other interviews that go on they might go on outside while we continue with the second panel. We thank you all very much for being with us.

Our second panel in order is Mr. Richard C. Loux, chairman of the Kansas State Corporation Commission; Ms. Edythe Miller, chairwoman of the Colorado Public Utilities Commission, Mr. Stanley York, chairman of the Wisconsin Public Utilities Commission, Ms. Susan Shanaman, chairwoman of the Pennsylvania Public Utility Commission; Mr. Henry Rollins, commissioner for the Texas Public Utility Commission; and Mr. Thomas Schneider, commissioner for the Montana Public Service Commission.

Thank you all very much for being with us. I think you all were here for most of the morning, and you heard the discussion with the previous panel. I believe you all know the rules and procedures of the subcommittee in which we ask you all to summarize your testimony. It will be included in full in the record, and then you'll have a chance to react to each other.

STATEMENTS OF RICHARD C. LOUX, CHAIRMAN, KANSAS STATE CORPORATION COMMISSION; EDYTHE S. MILLER, CHAIRWOMAN, COLORADO PUBLIC UTILITIES COMMISSION; STANLEY YORK, CHAIRMAN, WISCONSIN PUBLIC SERVICE COMMISSION; SUSAN M. SHANAMAN, CHAIRWOMAN, PENNSYLVANIA PUBLIC UTILITY COMMISSION; HENRY MOAK ROLLINS, COMMISSIONER, TEXAS PUBLIC UTILITY COMMISSION; AND THOMAS J. SCHNEIDER, COMMISSIONER, MONTANA PUBLIC SERVICE COMMISSION

Mr. LOUX. Thank you, Mr. Chairman. I will try to be very brief. I appreciate the opportunity to share with you the Kansas Commission's views on some of the telecommunications issues facing Congress. As expressed in more detail in my prepared statement, we believe comprehensive legislation is critically needed at this time, especially in view of the proposed A.T. & T. consent judgment.

Two items I want to mention, because I think most of the other points have been discussed earlier, and we certainly concur, the first is the matter of access fees. The Kansas Commission supports the concept of exchange access fees and the provisions of the House bill establishing a National Telecommunications Fund. We believe that the NTF is especially needed to protect Kansas rural ratepayers served by small independent companies with above-average costs of service.

In addition, the use of the NTF to ease the transition from the current separations and settlements procedures to the exchange access system is highly desirable.

A transition mechanism will be especially crucial if the exchange access system results in a significant shift of costs from interexchange to local exchange services, as some interests desire. The result of a change from use of SPF to SLU under the current separations process is reflected on the attachment. It is apparent that if a comparable impact occurs under the exchange access system, local rates will increase dramatically.

Although the NTF would hopefully ease in the transition, it would not shield ratepayers from such severe results indefinitely. The Kansas Commission does not believe that a reallocation of costs of such a magnitude is justified.

If all interexchange carriers pay equal charges for equal access, the interests of local exchange ratepayers need not be sacrificed for the sake of promoting competition. Furthermore, we strongly disagree with the view that current separations procedures create a subsidy for local exchange service.

As this subcommittee is aware, the crucial problem is the allocation of the costs of facilities which jointly provide both exchange and interexchange service. The costs of such facilities is not affected by their relative use for each service. Therefore, we have maintained the SLU is an inappropriate factor for allocating their costs.

At the same time, the Kansas Commission and others have noted that any allocation of costs must reflect the fact that these facilities are designed and engineered to accommodate the requirements of toll service. It is further obvious, but worth stating, that interexchange carriers could not provide service without using or duplicating the local exchange network.

We therefore propose that the costs of such non traffic-sensitive plant be allocated equally between exchange and interexchange operations. Such an allocation would, in our opinion, be fair and equitable, while avoiding the drastic impact which would result from use of SLU.

The second point I want to comment on is that one of the especially disturbing aspects of the A.T. & T. settlement is the apparent absence of representation of the interests of the soon-to-be divested BOC's, which now conflict with the interests of A.T. & T. Serious consideration should be given to appointment of a guardian to protect the best interests of the unborn children of Ma Bell.

The BOC's should have a separate voice in the determination of their futures with regard to transfer of assets, exchange access fees and future regulation. These determinations will greatly affect the ability of the local operating companies to provide service at affordable rates without a deterioration in quality.

In conclusion, we appreciate this opportunity and look forward to working with you as we have in the past.

[Testimony resumes on p. 297.]

[Mr. Loux's prepared statement and attachments follow:]

PREPARED STATEMENT
OF

Richard C. (Pete) Loux

Chairman
State Corporation Commission
Of the State of Kansas

Mr. Chairman and members of the Subcommittee.

On behalf of my colleagues, Commissioners Jane Roy and Phillip Dick, I greatly appreciate the opportunity to appear today and share with you our views on some of the telecommunications issues facing Congress. The State Corporation Commission is the regulatory body with jurisdiction over the provision of intrastate telephone services in Kansas. Our primary responsibility is to insure that such service is efficient and sufficient and provided at just and reasonable rates. Consequently, the Kansas Commission has followed with much interest and concern the activities and developments at the Federal level which would greatly affect the manner in which telecommunications services and products are provided and regulated.

There are, of course, three arenas in which telecommunications policies are being shaped. The FCC and its Federal-State Joint Board are struggling to implement the Second Computer Inquiry decision and are considering changes in the separations process. The U.S. District Court will apparently accept public comments on the proposed consent judgment which would fundamentally restructure AT&T and its operating companies. Lastly, this Congress has before it wide-reaching legislation to promote competition in telecommunications.

The Kansas Commission believes that only Congress can provide comprehensive policies for maintaining and improving telecommunications services while keeping it affordable to all. Legislation is undoubtedly needed to promote the benefits of new technology. It cannot be forgotten, however, that the most vital role of telecommuncations services is not the transmission of computer data or other "information". Plain old telephone service remains a universal necessity of life because it allows people to contact and communicate with each other. It is in this light that we generally support H.R. 5158. The provisions of this bill are clearly superior to those of S.898 in protecting telephone ratepayers from severe rate increases which could threaten the long established policy of universal service. Further, it is essential that this legislation be enacted to avoid the potentially drastic consequences of the AT&T consent judgment. There are, however, some improvements which should be made in the Bill.

Transition issues

The provisions of H.R. 5158 concerning deregulation of CPE, inside wiring and Yellow Pages will allow a much smoother transition than S.898 and the AT&T consent judgment. The drastic impact on local rates caused by deregulation of CPE and Yellow Pages is reflected on the attached schedules. Such significant increases should not be permitted to occur abruptly. H.R. 5158, by requiring continued provision of installed CPE until it is fully depreciated or sold to ratepayers provides a much preferable mechanism than the three year detariffing period contained in S.898.

We also believe that the House bill takes a more reasonable approach to treatment of Yellow Page operations than S.898. The offset of revenue requirements with reimbursements for fair market value of Yellow Page activities and other assets is an improvement over the four year reprieve in the Senate bill.

However, the Kansas Commission continues to have reservations about the deregulation of CPE and Yellow Pages. The goal of promoting competition is a worthy one, but it is unclear whether Kansas ratepayers will actually benefit from increased competition. Much of Kansas consists of sparsely populated rural areas with limited markets for telecommunications services and products. It appears to us that at the present time competition in Kansas is very limited in nature, especially in those rural areas. Whether significant competition for new CPE develops in the two years allowed under H.R. 5158 is problematical. The same is true of directory advertising. The profitability of this activity stems from the fact that telephone directories are provided to every monopoly ratepayer and should therefore benefit them. Although the monopoly ratepayer will receive some benefits from the reimbursement provisions in H.R. 5158, we are concerned that those reimbursements will not equal the actual profits which will continue to be made by the monopoly exchange carriers.

If deregulation is to be mandated, however, we believe that it should not follow the time schedules contained in the proposed AT&T consent judgment. It is unclear to us what is intended by the terms of that consent judgment precluding BOC provision of telecommunications products or customer premises equipment after reorganization. If this means that CPE will be detariffed after eighteen months, it will obviously result in an abrupt and disastrous impact on ratepayers. If it means that CPE will continue to be regulated but provided by the "new" AT&T, it will cause considerable regulatory chaos and customer confusion and, if CPE is removed from the separations process, will still result in drastic increases in local rates. The consent judgment also apparently envisions transfer of Yellow Page operations from the BOCs but is again unclear about the regulatory implications. Thus, it would seem that the consent judgment has ignored the consequences to consumers of removing CPE and Yellow Pages from local exchange service and has failed to provide for necessary transition mechanisms such as valuation of transferred assets. Congress cannot allow these deficiencies to stand and should modify the consent judgment along the lines of H.R. 5158. An alternative, if for some reason the time table of the consent judgment is not to be modified, would be for Congress to require AT&T reimbursement to the BOCs for the transferred assets at fair market value. Similar to Yellow Page operations, CPE fair market value should include the future stream of revenues from those assets. Regardless of the approach taken, it is imperative that Congress rectify the egregious terms of the proposed consent judgment. This should be done even if comprehensive telecommunications legislation cannot be enacted.

Access Fees.

The Kansas Commission supports the concept of exchange access fees and the provisions of the House bill establishing a National Telecommunications Fund (NTF). We believe that the NTF is especially needed to protect Kansas rural ratepayers served by small independent companies with above average costs of service. In addition, the use of the NTF to ease the transition from the current separations and settlements procedures to the exchange access system is highly desirable.

A transition mechanism will be especially crucial if the exchange access system results in a significant shift of costs from interexchange to local exchange services, as some interests desire. The result of a change from use of SPF to SLU under the current separations process is reflected on the attachment. It is apparent that if a comparable impact occurs under the exchange access system, local rates will increase dramatically. Although the NTF would hopefully ease in the transition, it would not shield ratepayers from such severe results indefinitely. The Kansas Commission does not believe that a reallocation of costs of such a magnitude is justified.

If all interexchange carriers pay equal charges for equal access, the interests of local exchange ratepayers need not be sacrificed for the sake of promoting competition. Furthermore, we strongly disagree with the view that current separations procedures create a subsidy for local exchange service. As this subcommittee is aware, the crucial problem is the allocation of the costs of facilities which jointly provide both exchange and interexchange service. The costs of such facilities is not affected by their relative use for each service. Therefore, we have maintained that SLU is an inappropriate factor for allocating their costs. At the same time, the Kansas Commission and others have noted that any allocation of costs must reflect the fact that these facilities are designed and engineered to accommodate the requirements of toll service. It is further obvious, but worth stating, that interexchange carriers could not provide service without using or duplicating the local exchange network. We therefore propose that the costs of such non-traffic sensitive plant be allocated equally between exchange and interexchange operations. Such an allocation would, in our opinion, be fair and equitable, while avoiding the drastic impact which would result from use of SLU.

Joint Board

The transitional Joint Board established by H.R. 5158 will play a critical role in determining how the transition to deregulation and competition will affect ratepayers. The determinations regarding valuation of transferred assets (including Yellow Pages) and exchange access fees must be made carefully and after consideration of all the consequences. Because state commissions are more familiar with the conditions and circumstances within their states, we believe that they are in a better position than a Joint Board to make determinations which will protect the interests of the carriers and their ratepayers. If, however, these critical decisions are to be taken away from the states, we would suggest some improvements to H.R. 5158.

The present provision for two state commissioner positions will give inadequate voice to the various state perspectives. We urge that the bill be amended to provide for at least four state commission positions on the Joint Board with no two commissioners be from the same geographic region.. Additionally, the provisions of the bill allowing delegation to state commissions of authority with regard to access fees and asset valuation should be made mandatory rather than permissive. Realistically, of course, the Joint Board cannot hope to make such determinations for the approximately 1,500 telephone companies in the United States. Such delegation should be required, however, to insure that the many small independents in Kansas are not burdened with proceedings before the Joint Board.

Intrastate Interexchange Jurisdiction

The failure of H.R. 5158 to provide for continued state jurisdiction over intrastate long distance is a great disappointment to the Kansas Commission, particularly when contrasted with the national trend to decentralization of government authority. We are not convinced that uniform intrastate toll rates are necessary for the promotion of interexchange competition. We are sure, however, that uniform rates would not benefit Kansas intrastate ratepayers. As shown on the attachment, which is an exhibit in the current Bell rate case, present intrastate long distance rates are below the comparable interstate rates. Even under the company's proposal, short haul rates will remain lower than present interstate rates. We thus suggest that removal of state regulation of interexchange service would not be beneficial to Kansas, especially those who make short haul calls.

At this point, we should note a related problem which exists under H.R. 5158. Increases in short haul toll rates will increase demands for Extended Area Service (EAS) which allows toll free calling between neighboring exchanges which share a community of economic or social interests. This service is primarily desired by rural customers who need to conduct social and business activities or contact institutions and emergency services outside the exchange where they happen to live. The Kansas Commission is currently attempting to implement procedures for determining when EAS should be provided. Without EAS, many rural customers must now pay at least $20-$30 a month for short haul toll calling. If uniform interexchange rates were established at the present interstate levels, those customers would pay 28¢ for the first minute and 15¢ for each additional minute of a fifteen-mile call compared to current Kansas rates of 15¢ and 9¢. Thus, it is evident that federal preemption of state toll services could lead to a doubling of long distance bills for many customers to $40-$60. Although many rural customers pay relatively low flat-monthly charges, it must be remembered that their basic monthly bill generally includes substantial but necessary short-distance toll calls. If uniform toll rates are mandated those basic bills will sharply increase, absent EAS.

H.R. 5158 does not appear to permit exchange carriers to provide EAS and, if interexchange service is removed completely from state jurisdiction, state commissions would be unable to respond to needs for such service. Conceivably the FCC could provide for EAS but the necessary proceedings may be overly burdensome to the parties involved. Therefore, if necessary EAS is to be provided, the only reasonable alternative appears to be a redetermination of exchange boundaries. Since the potential situations involve small adjoining exchanges, we do not believe that redefinition would adversely affect interexchange competition, as precluded by Section 231(c)(1) of H.R. 5158. It is unclear, however, whether redefinition is permitted after the termination of the transitional Joint Board and, if so, whether states must obtain approval of the FCC. Since state commissions are obviously closer to the problems and circumstances of local exchanges, they should retain the freedom to redefine boundaries. In any event a mechanism for provision of EAS should be included in Congressional legislation.

From a practical standpoint, giving total interexchange jurisdiction to the FCC will place a tremendous additional burden on that agency, while state commissions already have the necessary knowledge and resources to regulate intrastate rates. State commissions should therefore retain jurisdiction.

Depreciation and Accounting

The Kansas Commission currently has under advisement the question of whether Equal Life Group and Remaining Life depreciation methods should be permitted for Kansas jurisdictional telephone utilities. I therefore do not feel free to comment on the merits of such proposals. We do believe, however, that the authority to prescribe depreciation rates and methods for intrastate investment should remain with the state regulatory commissions. Although states generally agree with FCC prescribed depreciation rates, they should retain the freedom to independently determine what rates and methods are appropriate under the unique circumstances in their states. Likewise, we do not believe that it would be prudent for legislation to dictate what depreciation methods must be allowed by the FCC.

We believe that the same is true of regulated accounts and records. The FCC prescribed uniform system of accounts is generally followed by the Kansas Commission, but there may be situations where different regulatory concerns require different accounting. A revised accounting system will be of paramount importance in the future in insuring that regulated operations are kept separate from unregulated operations of telephone companies.

Other Concerns About H.R. 5158

We have not attempted to analyze all the provisions of H.R. 5158 in detail. However, there are some other deficiencies which we would like to note centering around which services will continue to be provided as regulated local exchange services. Firstly, H.R. 5158 does not exclude public coin phones from the definition of terminal equipment which is to be deregulated, as did the FCC's decision in Computer Inquiry II. Since competition in providing such service is neither desirable or practical in the forseeable future, we hope this oversight will be corrected. Secondly, it is unclear from H.R. 5158 and the AT&T consent judgment whether cellular radio will be considered an exchange service to be provided by regulated carriers. Since this nascent, but potentially profitable service, will be an adjunct to local telephone service and has been developed from local ratepayer financing, the BOCs should be allowed to operate the service so that exchange customers can share in the benefits. We have similar concerns about the provision of custom calling services. Although we appreciate the difficulty in distinguishing basic and enhanced telecommunications services, an exception should be considered for custom calling services, at least to the extent presently offered. Ratepayers are paying and will continue to pay the costs associated with the basic electronic central office equipment necessary to provide this service. Requiring separate provision of the service would be a less efficient means of returning the benefits of the investment to local ratepayers.

Concerns Regarding the AT&T Settlement

In addition to the concerns previously expressed, the Kansas Commission is greatly disturbed by other implications of the proposed AT&T consent judgment. As noted by many observers, the proposed "reorganization" allows AT&T to retain the highly profitable segments of the corporation while leaving the local exchange companies to fend for themselves. Thus, to cite perhaps the most outrageous example, AT&T intends to retain the lucrative Yellow Page activities. This business, which in Kansas generates gross revenues approximately five times the associated expenses, is clearly a local exchange function and not an interexchange operation. Just as clearly, in Kansas, no significant competition exists which justifies deregulation.

An especially disturbing aspect of the AT&T settlement is the apparent absence of representation of the interests of the soon-to-be divested BOCs, which now conflict with the interests of AT&T. Serious consideration should be given to appointment of a "guardian" to protect the bests interests of the unborn children of Ma Bell. The BOCs should have a separate voice in the determination of their futures with regard to transfer of assets, exchange access fees and future regulation. These determinations will greatly affect the ability of the local operating companies to provide service at affordable rates without a deterioration in quality.

Potential problems concerning the transfer of assets not previously mentioned include the determination of the depreciation reserves and accumulated tax deferrals associated with the transferred assets. Without a fair determination, the BOCs will receive inadequate financial resources, to the detriment of all ratepayers.

It would seem that the silence of the proposed settlement with regard to regulation has the consequence, if not the intent, of creating much confusion which may forestall needed legislative and regulatory action. Neither Congress nor regulatory agencies should stand by while AT&T implements the reorganization as it chooses. We are concerned that the settlement allows all competitive services to be provided by AT&T as a single entity which will undoubtedly dominate each of the competitive markets it enters. Although separate subsidiaries for each service may also weld overwhelming market power, Congress should consider a subsidiary requirement. At the very least a separate subsidiary should be required for the provision of regulated interexchange service, in order to deter cross-subsidization of regulated and unregulated services.

The implementation of the reorganization of the regulated local exchange companies also raises grave concerns for the Kansas Commission. The consent judgment apparently would allow all the BOCs to be consolidated into one entity. Although the license contract between AT&T and its current affiliates is to be terminated, it may be replaced with another arrangement which could require ratepayers to share in unnecessary costs and expenses of a giant corporation. At the same time, we recognize the efficiencies of a centralized technical support organization. In this regard it is unclear why the settlement in one section requires AT&T and Bell Labs to provide support to the BOCs on a priority basis after reorganization while in another section requires initial transfer to the BOCs of resources sufficient to meet their exchange function obligations. We are afraid that the BOCs will not, in fact, receive adequate resources so that they continue to be dependent on AT&T. The proposed judgment is not explicit concerning compensation, but we believe that BOCs should not be required to pay for essential support services provided by AT&T.

For all the above reasons, the Kansas Commission believes that it is critical for the consent judgment to be overridden so that the details and not just the broad outlines of the reorganization are subject to scrutiny and comment by all affected and concerned persons and entities rather than just the limited perspective of the Justice Department. Further, Congress should insure that state commissions have the authority and power to carry out their regulatory responsibilities both during any reorganization and thereafter. This should include the authority to inspect the books and records of, and require reports from, AT&T, its subsidiaries and the BOCs, as necessary.

In conclusion, I wish to emphasize that the Kansas Commission finds H.R. 5158 to be vastly preferable to S.898. Without the protections afforded in the House bill, Kansas ratepayers face abrupt doubling and tripling of their basic rates. Without those protections, the national goal of universal telephone service will be abandoned so that other, more limited, interests can prevail.

If the Kansas Commission and its staff can be of assistance to the Subcommittee, please do not hesitate to contact us. We will continue to analyze the specific provisions of the legislation so that any technical problems we see may be brought to your attention.

Thank you again for the opportunity to express our views on this critically important legislation.

ATTACHMENT I

IMPACTS INVOLVING CPE, YELLOW PAGES AND SPF/SLU

The attached schedules (1-5) reflect the impact of various regulatory changes on basic local service rates for companies providing over 90% of the total main stations in Kansas. Assumptions and sources of data are set forth separately.

1. The impact of CPE detariffing (Schedule 1, Column 2) appears to have roughly equivalent dollar impact on ratepayers in Kansas. Considering that the Southwestern Bell figure provided seems to include some allocated common costs (rather than direct costs only), the impact for over 90% of Kansas ratepayers would be approximately $4 per month.

2. The impact of changing from SPF to SLU (Column 3) is a much greater burden to the independent telephone companies of Kansas than to Southwestern Bell. Thus, for Bell the impact is approximately $3.25 while the impact on independents is $6.62 to $10.19. Even though the figures on Schedule 6 are not strictly comparable, having included additional impacts of deregulation of inside wiring and offsetting changes in separations, they nonetheless show increases of $6.78 to $12.57. The greater impact on independents is due to the fact that independent telephone company toll SPF's generally range from 70-80% while Southwestern Bell's toll SPF is 44% (as of December 31, 1980).

The urgency of the change from SPF to SLU is uniquely perceived by AT&T. SPF is the factor which determines the amount which aggregate toll revenues contribute to the costs of basic local distribution plant (NTS plant). Whatever contribution AT&T can eliminate from toll rate schedules (by changing from SPF to a lower allocation factor) must then be paid by local ratepayers. The AT&T incentive to "meet competition" in the long distance market by slashing its contribution to NTS costs must be clearly seen. The benefits of such an action would be reaped by large, high volume business users. The costs would be borne by local ratepayers who could afford to stay on the network.

3. The contribution of Yellow Pages revenues to local exchange operations is substantial. It is most important in metropolitan areas where the value of such advertising, hence rates, are high.

Thus, the impact for Bell is $2.10 while the independents show impacts of $.35 to $.93. AT&T seeks to include this highly profitable operation in its "competitive" subsidiary to provide "captive" financing, and thereby facilitate its development of competitive products and services. As stated in the text, Yellow Pages revenues should remain with local exchange operations.

4. The same general impacts and relationships would be observed in each state. We believe the universal service concept which maximizes the social value of the telecommunications network, would become an empty shell if deregulation is improperly analyzed and implemented.

Attachment 1
Schedule 1

COMPANY	Current Residential Rates and Local Exchange Revenues (12/31/80)		Impact of Detariffing Customer Premises Equipment Increase In:		Impact of Changing NTS Plant Allocation Factor from SPF to SLU Increase In:		Impact of Removal of Yellow Pages Operations from Local Ratemaking Increase In:		Prospective Residential Rates and Local Exchange Revenue Requirement		TOTAL PERCENT INCREASE
	Local Exchange Revenues	Monthly Rate	Local Revenue Requirement	Monthly Rate	Local Revenue Requirement	Monthly Rate	Local Revenue Requirement	Monthly Rate	Local Revenue Requirement	Monthly Rate	
Southwestern Bell of Kansas	$82,535,000	$8.45	51,648,000	5.29	31,627,000	3.24	20,500,000	2.10	$186,310,000	$19.08	126%
United Telephone Company of Kansas	$ 3,225,685	$5.30	2,563,023	4.21	4,028,000	6.62	565,578	.93	$10,382,286	$17.06	222%
Continental Telephone Company of Kansas	$ 3,875,000	$8.50	1,943,000	4.26	4,647,000	10.19	336,795	.74	$10,801,795	$23.69	179%
Southern Kansas Telephone Company	$ 219,658	$5.25	156,155	3.73	292,000	6.98	14,710	.35	$ 682,523	$16.31	211%

Attachment I
Schedule 2

POTENTIAL EFFECT OF SB 898 ON KANSAS JURISDICTIONAL LOCAL RATES

SB 898 Proposals include:

1. Removal of customer premises equipment (CPE) from ratemaking.
2. Changes in allocation of costs between local and toll services.
3. Also contemplates removal of Yellow Page operations from ratemaking.

Calendar Year 1980

COMPANY Southwestern Bell

Reduction in settlement revenues resulting from a change in method of allocating total costs between local and toll services (changing from SPF to SLU)	$ 31,627,000
Loss of separations support due to deregulation of CPE	$ 51,648,000
Subtotal	$ 83,275,000
Local revenue impact of removing Yellow Pages Operations from local ratemaking consideration	$ 20,500,000
TOTAL REDUCTION IN REVENUE	$ 103,775,000
Current revenues from local rates, not including terminal equipment charges	$ 82,535,000
PERCENTAGE INCREASE IN LOCAL REVENUE REQUIREMENTS	126 %

Base Rate Area - one party service

	Current Rate	New Rate	Percent Increase	NUMBER OF MAIN STATION IMPACTED
Business	$ 21.65	$ 48.93	126 %	121,087
Residential	$ 8.45	$ 19.07	126 %	676,955

Assumptions:

1. CPE revenue requirements were developed after an analysis of investment, depreciation reserve, depreciation expense, maintenance expense, and return.
2. Reduction in settlement revenue is defined as the effect of changing to SLU (Subscriber Line Usage) from SPF (Subscriber Plant Factor) for Non-Traffic Sensitive (NTS) Plant less CPE.
3. The revenue impact is distributed in proportion to existing business and residential tariffs.

Attachment I
Schedule 3

POTENTIAL EFFECT OF SB 898 ON KANSAS JURISDICTIONAL LOCAL RATES

SB 898 Proposals include:

1. Removal of customer premises equipment (CPE) from ratemaking.
2. Changes in allocation of costs between local and toll services.
3. Also contemplates removal of Yellow Page operations from ratemaking.

Calendar Year 1980

COMPANY United Telephone Co.

Reduction in settlement revenues resulting from a change in method of allocating total costs between local and toll services (changing from SPF to SLU)	$ 4,028,000
Loss of separations support due to deregulation of CPE	$ 2,563,023
Subtotal	$ 6,591,023
Local revenue impact of removing Yellow Pages Operations from local ratemaking consideration	$ 565,578
TOTAL REDUCTION IN REVENUE	$ 7,156,601
Current revenues from local rates, not including terminal equipment charges	$ 3,225,685
PERCENTAGE INCREASE IN LOCAL REVENUE REQUIREMENTS	222 %

Base Rate Area - one party service

	Current Rate	New Rate	Percent Increase	NUMBER OF MAIN STATION IMPACTED
Business	$ 11.95	$ 38.48	222 %	11,033
Residential	$ 5.30	$ 17.06	222 %	52,583

Assumptions:

1. CPE revenue requirements were developed after an analysis of investment, depreciation reserve, depreciation expense, maintenance expense, and return.
2. Reduction in settlement revenue is defined as the effect of changing to SLU (Subscriber Line Usage) from SPF (Subscriber Plant Factor) for Non-Traffic Sensitive (NTS) Plant less CPE.
3. The revenue impact is distributed in proportion to existing business and residential tariffs.

Attachment I
Schedule 4

POTENTIAL EFFECT OF SB 898 ON KANSAS JURISDICTIONAL LOCAL RATES

SB 898 Proposals include:

1. Removal of customer premises equipment (CPE) from ratemaking.
2. Changes in allocation of costs between local and toll services.
3. Also contemplates removal of Yellow Page operations from ratemaking.

Calendar Year 1980

COMPANY Continental

Reduction in settlement revenues resulting from a change in method of allocating total costs between local and toll services (changing from SPF to SLU)	$ 4,647,000
Loss of separations support due to deregulation of CPE	$ 1,943,000
Subtotal	$ 6,590,000
Local revenue impact of removing Yellow Pages Operations from local ratemaking consideration	$ 336,795
TOTAL REDUCTION IN REVENUE	$ 6,926,795
Current revenues from local rates, not including terminal equipment charges	$ 3,875,000
PERCENTAGE INCREASE IN LOCAL REVENUE REQUIREMENTS	179 %

Base Rate Area - one party service

	Current Rate	New Rate	Percent Increase	NUMBER OF MAIN STATION IMPACTED
Business	$ 13.65	$ 38.08	179 %	5,178
Residential	$ 8.50	$ 23.72	179 %	40,336

Assumptions:

1. CPE revenue requirements were developed after an analysis of investment, depreciation reserve, depreciation expense, maintenance expense, and return.

2. Reduction in settlement revenue is defined as the effect of changing to SLU (Subscriber Line Usage) from SPF (Subscriber Plant Factor) for Non-Traffic Sensitive (NTS) Plant less CPE.

3. The revenue impact is distributed in proportion to existing business and residential tariffs.

Attachment I
Schedule 5

POTENTIAL EFFECT OF SB 898 ON KANSAS JURISDICTIONAL LOCAL RATES

SB 898 Proposals include:

1. Removal of customer premises equipment (CPE) from ratemaking.
2. Changes in allocation of costs between local and toll services.
3. Alro contemplates removal of Yellow Page operations from ratemaking.

Calendar Year 1980

COMPANY Southern Kansas

Reduction in settlement revenues resulting from a change in method of allocating total costs between local and toll services (changing from SPF to SLU)	$ 292,000
Loss of separations support due to deregulation of CPE	$ 156,155
Subtotal	$ 448,155
Local revenue impact of removing Yellow Pages Operations from local ratemaking consideration	$ 14,710
TOTAL REDUCTION IN REVENUE	$ 462,865
Current revenues from local rates, not including terminal equipment charges	$ 219,658
PERCENTAGE INCREASE IN LOCAL REVENUE REQUIREMENTS	211 %

Base Rate Area - one party service

	Current Rate	New Rate	Percent Increase	NUMBER OF MAIN STATION IMPACTED
Business	$ 8.50	$ 26.43	211 %	361
Residential	$ 5.25	$ 16.31	211 %	3,190

Assumptions:

1. CPE revenue requirements were developed after an analysis of investment, depreciation reserve, depreciation expense, maintenance expense, and return.

2. Reduction in settlement revenue is defined as the effect of changing to SLU (Subscriber Line Usage) from SPF (Subscriber Plant Factor) for Non-Traffic Sensitive (NTS) Plant less CPE.

3. The revenue impact is distributed in proportion to existing business and residential tariffs.

Attachment I
Schedule 6

IMPACT OF PROPOSED CHANGES ON SEVEN KANSAS TELEPHONE COMPANIES

COMPANY	CURRENT RESIDENTIAL RATE	IMPACT OF CPE DETARIFFING	SPF TO SLU, AND INSIDE WIRE DEREGULATION	POTENTIAL RATE
Haviland	$5.00	$5.95	$ 9.66	$20.61
Jetmore	$7.25	$8.54	$10.45	$26.24
Sunflower	$6.00	$7.68	$12.57	$26.25
Totah	$8.00	$2.07	$ 9.07	$19.14
Twin Valley	$6.75	$3.54	$10.54	$20.83
Wamego	$7.50	$2.71	$ 6.78	$16.99
Wilson	$7.25	$4.65	$10.79	$22.69

Assumptions

1. Separations modified as proposed to Joint Board by AT&T.
    a) Flash cut removal of terminal equipment from jurisdictional separations process.
    b) Reduce SPF to SLU (as modified below) over a five year period.
    c) Interstate SLU factor includes all interstate minutes of use associated with interstate FX, CCSA, private line, ENFIA, MTS, and WATS services.
    d) Use of seven day holding time studies.

2. Inside wire contribution is lost due to deregulation.

3. Impact is distributed in proportion to main stations rather than local revenues.

4. Impact of Yellow Pages removal not calculated.

5. Current Residential Rate is a "bundled" rate.

SOURCE: Ernst & Whinney, Tacoma, Washington

ASSUMPTIONS AND SOURCES FOR ATTACHMENT I, SCHEDULES 1-5

1. The Local Exchange Revenues in Column 1 represent total revenues derived from business and residential monthly billings for calendar year 1980. Revenues derived from extension rentals, mileage charges, station connection charges, and other charges are not included. It is assumed that any revenue increases from CPE detariffing, changing from SPF to SLU, or removal of Yellow Pages will be borne by ratepayers through the monthly basic charge.

2. The Monthly Rate for Southwestern Bell, United and Continental in Column 1 is the "unbundled" rate for 1-party residential service, and does not include charges for the telephone instrument or taxes. We have adjusted data from Southern Kansas to assume unbundling at $1.25 per instrument.

3. The Local Revenue Requirement in Column 2 is intended to represent the contribution from toll rates (via the SPF factor) to direct CPE costs. However, the figure provided by Southwestern Bell appears to include a portion of allocated common costs and likely overstates slightly the direct impact of CPE detariffing.

   The figures for the other three companies are staff calculations of the direct cost of CPE investment. The elements (obtained from 1980 Annual Report data) are return on investment, depreciation expense, and maintenance expense.

   The monthly rate impact is calculated by expressing the total revenue impact as a percentage of 1980 Local Exchange revenues (Column 1), and applying that percentage to the current monthly rate.

4. Implicit in the above calculation of the monthly impact is that the revenue impact will be distributed over business and residential customers in equal percentages rather than equal dollar amounts.

5. Southwestern Bell provided the "SPF to SLU" impact in Column 3 for itself, United Telephone Company and Continental Telephone Company. Southern Kansas Telephone Company provided its impact estimate. The impacts represent the increase in costs allocated to local exchange resulting from application of SLU rather than SPF to non-traffic sensitive plant, not including CPE. The monthly rate impact is distributed in the same fashion as stated in 4 (above).

6. The Yellow Pages Contribution in Column 4 is the excess of Directory Advertising and Sales Revenues over Yellow Pages Directory Expenses, using calendar year 1980 Annual Report data. The monthly rate impact is distributed in the same fashion as in 4 (above).

ATTACHMENT II

Southwestern Bell Telephone Company
State of Kansas - Docket No. 128,811-U
Long Distance Message Telecommunications Service
Comparison of Rates

Southwestern Bell-Kansas			AT&T Interstate	
Rate Mileage	Present Rate	Proposed Rate	Present Rate	Rate Mileage
Direct Dial - Day Rate - Initial 1 Minute				
1-12	$ .12	$ .18	$ .23	1-10
13-16	.15	.22	.28	11-16
17-20	.18	.27	.32	17-22
21-25	.21	.33	.38	23-30
26-30	.25	.37		
31-40	.29	.41	.43	31-40
41-55	.33	.44	.48	41-55
56-70	.36	.47	.50	56-70
71-85	.39	.49	.52	71-124
86-105	.43	.51		
106-170	.45	.53	.53	125-196
171 & Over	.46	.56		
			.56	197-292(1)
Each Additional Minute				
1-12	$ .06	$ .08	$ .10	1-10
13-16	.09	.12	.15	11-16
17-20	.12	.15	.17	17-22
21-25	.15	.20	.22	23-30
26-30	.19	.22		
31-40	.23	.26	.26	31-40
41-55	.26	.29	.30	41-55
56-70	.28	.31	.32	56-70
71-85	.30	.33	.35	71-124
86-105	.31	.35		
106-170	.32	.37	.37	125-196
171 & Over	.33	.39		
			.39	197-292(1)
Service Charges				
Operator Station-to-Station	$0.60	$1.05	$0.60-1.85(2)	
Person-to-Person	1.70	2.40	3.00 (2)	
Dial Credit Card Station-to-Station	-	0.35	0.50 (2)	

Notes: (1) Mileages greater than 292 are charged higher rates.
(2) Service Charges proposed for interstate operator handled calls.

Mr. **Wirth**. Thank you very much. You pronounce your name "Lock," is that correct?

Mr. **Loux**. Yes.

Mr. **Wirth**. We appreciate also your right-to-life suggestion, Mr. Loux.

Ms. Miller.

STATEMENT OF EDYTHE S. MILLER

Ms. **Miller**. Thank you, Mr. Chairman, I would also like to express my appreciation to you and your subcommittee for hearing the State regulators and hearing from State commissions generally.

I might add that I have never, I think, seen the level of unanimity that exists among State commissions as today. I am sure you understand this is a normally contentious group as any diverse body is, and there is strong agreement that this—the proposed settlement, added to the Senate bill could seriously impact the rates of consumers' local service. I don't want to go over what has been gone over. I will try to be very, very brief. I think the major points we are stressing are evaluation, access, and yellow pages advertising.

In regard to evaluation, I think it is important, as the House bill does, to consider the going concern value, including such aspects of the value as the fact that local ratepayers have been paying through their rates, through the license contract fee, for the development of many of the products that are going to be transferred. It is important that this transfer occur at the going concern value of these assets. The area of yellow pages advertising for Mountain Bell, Colorado, alone, our staff has estimated that we are talking about a loss of revenues in the area of over $20 million per year. Now, as you are very well aware Colorado is a small State. This would be a very substantial figure. In terms of access, I think it is important to note that costing and pricing are far from an exact science. When it comes to access we are dealing with joint facilities. It is very difficult to cost and price these joint facilities. I think it is extremely important that the access include a procedure whereby State regulators have important input into the processes of determining the methodology by which access will be determined.

I have one further point. I think there are benefits to be had from competition and these benefits primarily have to do with the new and sophisticated equipment which will be available through the competitive forces that will be let loose. But, there are many, many consumers out there whose communication needs are for basic, simple service. I would hope, and I think that you have done an excellent job in attempting to protect the simple consumer needs of those whose needs are simply for basic communications.

Let me say again that I do thank you for giving us this opportunity to be here.

[Ms. Miller's prepared statement follows:]

EDYTHE S. MILLER
CHAIRWOMAN
COLORADO PUBLIC UTILITIES COMMISSION

Chairman Wirth, Members of the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, first of all I would like to express my appreciation for the opportunity to address you on the important topic of H.R. 5158, the "Telecommunications Act of 1981," and on the significance for H.R. 5158 of the settlement agreement recently entered into between AT&T and the Department of Justice, should it be accepted by the Court. Needless to say, the topic is one of enormous importance from both a micro and a macro viewpoint; in the former sense in light of its impact upon the nation's telecommunications users and taxpayers; in the latter sense, in view of its impact upon the industrial structure of the nation. The time allotted is brief and I will therefore of necessity be able to treat the topic only summarily. I will attempt to address areas which seem to me to have substantial potential impact.

I would suggest that the settlement agreement between AT&T and the Department of Justice makes the drafting and passage of federal legislation even more imperative than previously. The settlement sets forth some broad parameters, but in many areas the settlement is lacking in detail. Indeed, the settlement calls for the details to be provided some six months hence. I would suggest that the results, from both a micro and macro perspective, lie in the details, in the filling in of the ambiguities and gaps in the agreement. The way in which those ambiguities are removed or otherwise clarified and the gaps are filled will determine whether the very worthy goals set forth in H.R. 5158 are achievable and will determine as well the ability to continue the largely fulfilled goal of universality of service. Legislation is necessary both to clarify the ambiguities and to fill the gaps which may be unresolved by the settlement agreement and its implementation.

First of all, I would suggest that the settlement raises jurisdictional questions. My reading of the agreement leaves me unclear in some regards as to where federal jurisdiction ends and state jurisdiction begins. For example, the settlement, unlike the proposed legislation, is unclear as to who regulates intrastate toll. It is clear that the consent decree prohibits operating companies from providing intrastate toll, but its regulation is not, so far as I am able to determine, specified. Legislation would seem to be necessary to clarify this issue.

In addition, whereas the settlement prohibits the BOCs from manufacturing or providing CPE or any telecommunications product or service not regulated by tariff, it does not specify either a process or a methodology for evaluation of deregulated or transferred assets. Rather, it requires AT&T, as part of its divestiture of operating companies, to submit in six months' time a plan for valuation of assets subject to transfer or deregulation. The impact upon the operating companies and their customers will vary, depending upon the details of that plan. To protect the local ratepayer, legislation should spell out both a process and a methodology. Procedurally, I would hope that H.R. 5158, in its final form, as in the earlier version which I have been privileged to see, will assign that task to a joint board. I would suggest that state involvement in that board should be sizable, and that the decisions of the joint board be administratively final.

The methodology employed will determine the value of the assets involved. I would submit to you that the transfer price of assets is crucial. Undervaluation of assets has the potential to disadvantage local ratepayers severely. Legislation should spell out an evaluation methodology which includes the going concern value of assets. For example, the license contract payments which over the years have been assessed to the local ratepayer through the rates for research and development of products which now are to be deregulated or transferred should be factored into the valuation methodology, as should the goodwill value of the Bell name which inheres in these products. Legislation also must deal with the important question of how joint plant is to be valued and, for that matter, regulated.

An additional topic which legislation should address is that of access charges. The settlement agreement establishes a system of access tariffs which is to replace the current division of revenues between AT&T and the operating companies. Thus, the separations and settlements process is replaced by an access charge. Again, the settlement sets forth a broad brush outline, but is skimpy on details. The operating companies are required to provide nondiscriminatory, cost-justified access to the local loop to all interconnect entitites. But, as we are all too well aware, costing frequently is more an art than a science. Joint and common costs cannot be directly assigned precisely because there exists no theoretically preferred method for the allocation of nontraffic sensitive costs to local and federal jurisdictions. Any allocative methodology must incorporate judgments which, of necessity, are arbitrary. This is unavoidable, a function of the nature of joint costs and the fact that joint costs permeate telecommunications services. But decisions in regard to the level and structure of the access charge will have to be made. Again, I would suggest that state involvement in that decision-making process be sizable, and that decisions of the responsible body be administratively final. The decisions will greatly influence the level and structure of local rates and, indeed, may be dispositive of our ability to maintain universality of service.

I would like to raise an additional point which seems to me to be of both philosophic and financial importance. From my vantage point, it seems that the state regulators are as united on this as I have ever known them to be on anything. Legislation should spell out that since directory advertising has value only because it is a component of a subscriber listing service which is an inherent part of local service, revenues derived from such advertising should be available for local exchange ratemaking. Directory advertising generates no inconsiderable sums. Nationally, revenues of about $2 billion dollars are involved. In Colorado, our staff estimates that directory advertisement accounts for revenues of over $20 million annually for the Bell Company alone. Since the early days of telephone service, state commissions and courts have held that telephone directories are an essential part of local service. Telephone companies historically have permitted advertising as an incident to the publication of telephone directories. The value of advertising in telephone directories is the local telephone company's ability to place a directory in every subscriber's home and business. In the state of Colorado 95% of all residences and, we assume, close to 100% of all businesses have telephone serivce.

Let me mention very briefly some additional topics that I feel are inadequately addressed in the settlement and would seem to require your attention. First, the consent decree does not set forth the structure of the spin-off; e.g., whether the operating companies are to be spun off as one company, six companies, 22 companies, or some other variation. The shape the divestiture takes may influence the provision of telecommunications services and may be an area which legislation should address. Also requiring attention, it seems to me, is the question of how the divestiture and transfer will affect the capital structure and costs of the operating companies. This detail has not been addressed in the settlement agreement. However, it should be obvious that whatever capital structure or structures result for one or more operating companies will have significant impacts for those companies in the capital markets. In addition, the question of jurisdictional authority for setting depreciation rates will affect both the value of the transfer and local subscribers' rates.

I would like to bring one last point to your attention. To soften the impact upon the local ratepayer at a time of momentous change in telecommunications, you may wish to consider maintaining in H.R. 5158 the provision which keeps embedded equipment tariffed until depreciated, and then available for auction by state PUCs. This will, of course, have the effect of slowing down, but not stopping, the transfer process, and thereby mitigating to some extent its impact.

We are poised at the threshold of unprecedented change in telecommunications technology and industrial structure. New and sophisticated equipment soon will enable us to engage in communications activities previously encountered perhaps only in the science fiction literature. It is an exciting time to be involved in the sector. However, I think we must be mindful of the fact that there are thousands and probably millions of consumers who have only simple communications needs and wants, and we must be careful to protect those consumers from the cost increases associated with the new services while ensuring their continued ability to fulfill their need for basic communication.

I am most grateful for the opportunity you have afforded me to address you on these important issues.

Mr. WIRTH. Thank you very much, Ms. Miller.
Mr. York.

STATEMENT OF STANLEY YORK

Mr. YORK. Thank you. To your great relief I will not repeat the position that others have taken but will second them and make a couple of observations on some issues that have been raised that have not been discussed in much detail.

Our concern is the ability of the operating companies to survive. You have heard us discuss at some length the ability to compete and the questions that revolve around the division of assets and how they get decided, and the conflict of interest question; as well as jurisdiction over intrastate activities and that includes the access charge questions.

But, I would like to move to a couple of other things. The first is we are talking about the mechanics of transition and we are very much concerned with your bill and the other things going on. The transition mechanics must not destroy the system so none of us get to the intended result. That is why many of us are supporting many elements of H.R. 5158. Specifically as to SPF and SLU, the real concern is not a philosophical commitment to a particular method of pricing telephone service. It is to a transition from a known method with known impacts to an unknown method with the possibility of serious impacts hitting us along the way as we get there. Each of these things is a part of a total proposal. Our commitment is that the total does not unduly harm the monopoly ratepayer. We would like to see the pieces fit together and we are flexible on a number of pieces so long as the final result is not damaging to those ratepayers.

In regard to the question of whether it is time now for legislation, I would like to say a very strong yes, but for a reason different from the one that was given by others. The settlement agreement deals with only a small part of what we are talking about. It speaks only to dealing with the antitrust issues of one part of that industry.

You are dealing with the impact on independents; the settlement agreement is only peripherally concerned in that area. So, we strongly urge you go forward as rapidly as you can and we have done everything we can to help you move in this direction.

In response to a specific question, saying why don't we get the people together to get a consensus, let me respond to that, speaking only for myself, you are dealing with divergent interests. I do not think consensus is possible. There will be tough judgments with political repercussions but the job will not be done unless those judgments are made and the decisions go forward.

Third, it is very hard for me to take off my telephone hat and put on another hat. I am studying diversification primarily in the energy industry but also for telephone. Everybody wants diversification, I am talking about industry people, including the telephone industry, including A.T. & T., for legitimate economic and technical kinds of reasons; but, note, there is one group from whom diversification is precluded: the local operating company, the spun off BOC. That causes me very serious problems not only in terms of the viability of the local operating company, but clear discrimination against one arm of the industry that ought to be able to provide the broader kind of service for the basic economic reason of diversification: when one side is up, the other is down. The down side is supported by the up side. As you go through economic swings you get this kind of balancing which makes the whole industry healthier for all concerned.

My concluding comment is a very selfish one. It has to do with the present drift of things. If that drift is allowed to continue, you put commissioners, State commissioners, in the choice between approving a deterioration of service or approving rates that drag people out of the ability to get service.

For me, that is no choice and, if some of you are familiar with what we are doing with purchased gas adjustment clauses, we at the State level hold our noses and pass through the kind of impacts developed by the Federal Energy Regulatory Commission. We strongly urge that you go forward with the kind of legislation that you are, so that we are not put in that position in regard to the telecommunications industry.

We strongly support competition and meaningful transition that gets us to competition in an effective way.

Thank you for the opportunity to share these views.

[Mr. York's prepared statement follows:]

Testimony of Stanley York
Chairman, Public Service Commission
of Wisconsin

Thank you for the opportunity to appear before this committee and to present a state regulator's point of view on the changing telecommunications industry. My primary concern is that the interests of the monopoly ratepayer be considered when decisions are made with regard to H.R. 5158, Senate Bill 898, and the recent American Telephone & Telegraph (A.T.&T.) proposed divestiture settlement.

As a state regulator it is my responsibility to assure for Wisconsin ratepayers, adequate service at just and reasonable rates. We agree with the basic premise that we should deregulate where markets are competitive and we should promote competition, when appropriate, where they are not. However, a critical balancing act is needed to assure that universal local service is not destroyed in the process. We believe that state commissions are in the best position to oversee the maintenance of reliable, reasonably priced, universal local telephone service.

Some elements of these bills and the settlement agreement work for this principle, but some work against it. In the interest of time I will limit my comments to the most significant issues.

1. We urge you to permit the local operating companies to enter competitive markets.

The proposed AT&T divestiture agreement and the proposed legislation place significant restrictions on the local operating companies' ability to enter competitive markets. This leaves the local operating company with that portion of the business that has the lowest profit potential and the most limited prospects for growth, and removes from local revenues the contributions from long-distance traffic, terminal equipment, inside wiring, and yellow pages advertising. The yellow pages issue is one of the clearest indicators of the potential impact on local rates. For the six largest telephone utilities in Wisconsin (we have 110 in total) the excess of yellow pages revenue over costs in 1980 were approximately 24½ million dollars. If this revenue source is removed from consideration in local rate setting it equates to over $1 per month per customer. Although $1 per month does not sound excessive, this is only one of many potential impacts on local rates. It is the sum of these seemingly small impacts that is of real concern to a state regulator.

Admittedly the question of whether these directory advertising revenues should be considered in setting local rates is one about which my own collegues and I disagree; however, we do agree on one thing. The loss of yellow pages revenue contributions will fall on local rates, the province of the state commissions. The local users will express their anger on this change to us; at the very least it should be those of us at the state level that make the decisions that create this impact.

The local operating companies should be given a fighting chance to maintain quality service and prosper by entering these competitive markets. This would allow customers to select their service options from an expanded variety of available sources including the local company, a qualified, experienced vendor.

2. State commissions should have jurisdiction over inter-exchange-intrastate toll and quality of service including the authority to mandate extended area service (EAS) or local measured service (LMS).

The loss of state jurisdiction over intrastate long-distance service is one element of the legislative proposals against which we at the state level have argued consistently since the emergence of the idea. We continue to believe that state jurisdiction should prevail over all toll traffic originating and terminating within the state. Federal regulation here is just not in the interest of ratepayers.

For the majority of the toll calls placed within Wisconsin, for instance, current FCC-regulated interstate rates are higher than state regulated intrastate rates. That competition or deregulation will push these short haul rates down in the near future (if ever) seems doubtful. Competitors may well view service expansion unattractive for years to come in these intrastate markets where toll calling is diffused among many local calling centers or where the volume of traffic is sparse.

The proposal to expand federal jurisdiction and policy to intrastate toll service seems a case where the theories of competition ignore the realities of average telephone users paying their bills for the calls they make.

The jurisdictional boundary for toll under the proposed settlement agreement is unclear. These murky waters of the inter-intra state toll matter are further muddied by the configuration of exchange areas using the Standard Metropolitan Statistical Area (SMSA) concept. We see no benefits deriving from the SMSA proposal. We do see significant confusion. The drawing of local exchange areas according to SMSA guidelines will create artificial boundaries with inappropriate effects. A caller residing near a boundary will make state-regulated calls in one direction and separately regulated or federally-regulated calls in the other. This may not reflect the zone of viable competition for that caller's business. It would also frequently disrupt extended area services now provided in many states. The question of local calling areas is one of great local concern in Wisconsin as are the rates for those services. The decisions on local services belong with the states.

This problem would be obviated by retaining the present demarcation between state and federal toll jurisdiction, with state commissions maintaining regulatory authority with respect to intrastate long distance services.

3. State commissioners should have jurisdiction over setting access charges and decisions should be subject to state review procedures.

The setting of the access fee will be critical to maintaining the integrity of basic local telephone service. By giving the responsibility for setting these fees to the Transitional Joint Board or the FCC, you put the state utility commission in an untenable position. You would place us in charge of regulating basic local telephone service with no control over the level of revenues to be devoted to it. Neither a part-time joint board of 5 people nor the FCC in the nation's capital, are likely to be able to respond adequately to the concerns of 22 BOC's and thousands of independent telephone companies across the country. State commissions can be more responsive to particular community needs.

4. BOC's and independents should be treated in the same manner in regard to access charge requirements.

H.R. 5158 allows the Transitional Joint Board to assist smaller exchange carriers to maintain reasonable rates as it sets the access charges. The proposed AT&T divestiture agreement is silent on this issue.

This issue must be addressed so that independent telephone companies are not thrown into chaos in the determination of access charges. The recognition in H.R. 5158 of the need to maintain reasonable rates during the transition is critical to the success of any deregulation proposal.

5. State commissions should have direct access to AT&T books, records and officers for the review of decisions relating to valuation, distribution and depreciation of property; relating to debt and equity determinations; and similar matters.

The proposed legislation as well as the proposed AT&T divestiture contemplate the arduous task of determining the value of utility plant. The legislation provides that the FCC and the Transitional Joint Board are intermediaries in the flow of information. This could be very cumbersome as our on-site state auditors begin work on Wisconsin Telephone Company. I would prefer that the states have direct access to AT&T books, records and officers.

In conclusion, we are in favor of permitting and promoting competition in the telecommunications industry when it will work for public interest. However, we caution that unless great care is exercised in the transition to a more competitive marketplace, universal local telephone service as we know it today may well be destroyed. I urge you to avoid this disaster by permitting the operating companies to compete, and by establishing state jurisdiction over intrastate service and the setting of access charges. Thank you.

Mr. **Wirth**. Thank you very much, Mr. York.

Ms. Shanaman.

STATEMENT OF SUSAN M. SHANAMAN

Ms. **Shanaman**. Thank you.

The telecommunications revolution began in 1956 with the FCC's *Hush-a-Phone* decision. The coup occurred on January 8, 1982, when the DOJ and A.T. & T. announced the modification of the 1956 consent decree.

The impact of "Fateful Friday" will be felt by every consumer of telecommunications service in the country.

To encourage full development of technological advancement of telecommunications, the FCC and Congress moved toward reliance upon competition—not regulation.

The appropriateness of competition cannot now be questioned. But our zeal for competition must not obfuscate this Nation's goal, and that is affordable telephone service for all persons.

Competition will be beneficial. Its effects can offset a portion of any resultant increase in basic service costs. But not for everyone.

In any given month in Pennsylvania, over half of residential telephone customers do not make a single toll call. The benefits of competition envisioned by A.T. & T., DOJ, and Congress will not be apparent to those constituents.

It is clear that the settlement agreement does not adequately address some very basic issues. It remains the responsibility of Congress to safeguard the interests of ratepayers of regulated services to continue to enjoy access to high quality universal service at affordable and reasonable rates.

I don't think it is necessary to go into great detail. The concerns we have all expressed here today in terms of some of the specifics, primarily determining which assets are to be transferred, determining the valuation of the assets to be transferred and the method of compensation for those assets to be transferred, I think you have heard from all of us that, indeed, we feel we must have some say in how that is developed.

The act's impact cannot be assessed until the plan is submitted. As the prior discussion was, I think, with Congressman Dingell, it is not certain that we have that ability now, it may be necessary to have Congress provide that authority to us.

Access charges, again, to repeat that, certainly we need that kind of ability on the State level, to be able to determine what those access charges are.

EXCHANGE BOUNDARIES

From the perspective of a State regulator, jurisdictional boundaries should recognize the political entities in which the customer resides and to whom the regulators are responsible for the rates and service within the boundaries.

Currently, boundaries meet this criteria for the regulatory agencies exercising local exchange regulation as to rates and service.

New developments in extended area of service [EAS], optional extended area service, and local community interest calling are keyed primarily to local and area services based upon political boundaries, such as police and fire protection, medical and social services, school districts, and churches.

State commissions have proven to be highly capable of regulating intrastate interexchange services. There is no evidence to indicate that we will be any less capable of performing regulatory functions mandated by future legislation.

Another reason for the States to retain that jurisdiction is because many plans are largely related to the intrastate toll jurisdiction.

In many States, these are so universally used that the public equates them to universal basic service also.

YELLOW PAGES

I would repeat the concerns of my fellow commissioners, that these are not a competitive service, they are not of national interest, they provide local advertising by local businesses or professions for local consumers.

Their loss in Pennsylvania would mean about $1.05 per month for most urban areas added to the bill. I would agree, again, that there is no reason to deny the Bell operating companies opportunities for growth by permitting them to provide CENTREX service, custom calling services and cellular radio systems.

One thing that Chairman York has indicated is certainly while we are here discussing the settlement agreement, we are here discussing your legislation which does, indeed, deal with independent companies.

Pennsylvania has 57 independent telephone companies. And they are quite concerned about what the impact will be upon their customers.

Their concern relates to the impact of the A.T. & T. in their territory. I think it is something that we have to consider in terms of legislation, in terms of the independent beliefs that the embedded telephone company terminal equipment should continue under State regulation, that the present level of access payments to telephone companies by other carriers should continue until parity is established and that legislation should provide payments to insure reasonable rates for customers in sparcely populated rural areas.

I have included in appendix A of my testimony what we consider a representative independent telephone company in Pennsylvania and to look at the impact that might be had on those customers, you see an almost doubling of the bill.

For deregulation of terminal equipment, deregulation of inside wiring and yellow page advertising, it is an additional $8.25 per month, which is, in effect, almost a doubling.

I would also like to add, perhaps, an experience that we have had in Pennsylvania, and relate to a question originally proposed when we started out, that is what kind of elasticity will there be in customers' use as a result of maybe even only a 10-percent increase?

The Pennsylvania Commission, about 8 months ago, provided for an increase in service rates to a small independent telephone company of approximately $4 a month. This was about a 20-percent increase in their charges. And nearly one-third of the customers of that system went off the system.

And 6 months later, they are still off the system. There is definitely an elasticity of the price of telephone service and we are very concerned that we will lose the basic principle of universality of telephone service.

Congress now has the unique ability to legislatively reaffirm the principle of universal telephone service at affordable rates.

The urgencies of rapid developments in telecommunications does not exempt us from continuing to evaluate the impact of competition, not merely the question of whether competition is feasible, in this or that segment of telecommunications.

The more basic question of the long-term effects of these issues and the public at large is how it is likely to affect the adequacy, dependability and availability of telephone service and the price the public will have to pay for it.

I say this because of your responsibility to the public at large, and not to some customers, but to all customers and not only to today's public, but tomorrow's as well.

Thank you very much.

[Testimony resumes on p. 321.]

[Ms. Shanaman's prepared statement and attachment follow:]

Testimony of

Susan M. Shanaman, Chairman
Pennsylvania Public Utility Commission

The telecommunications revolution began in 1956 with the FCC's Hush-a-Phone decision. The coup occurred on January 8, 1982 when the DOJ and AT&T announced the modification of the 1956 Consent Decree. The impact of "Fateful Friday" will be felt by every consumer of communications service in the country.

To encourage full development of technological advancement of telecommunications, the FCC and Congress moved toward reliance upon competition -- not regulation. The appropriateness of competition cannot now be questioned. But our zeal for competition must not obfuscate this nation's goal since 1934 -- affordable telephone service for all persons.

Competition will be beneficial. It's effects can offset a portion of any resultant increase in basic service costs. But not for everyone. In any given month in Pennsylvania, over half of residential telephone customers do not make a single toll call. The benefits of competition envisioned by AT&T, DOJ and Congress will not be apparent to those constituents.

It is clear that the settlement agreement does not adequately address some very basic issues. It remains the responsibility of Congress to safeguard the interests of ratepayers of regulated services to continue to enjoy access to high quality universal service at affordable and reasonable rates.

VALUATION OF ASSETS

Because there is no reason to expect that AT&T will have any reason to advance the interest of the states, it is important that states be given the opportunity to comment upon both the valuation and method of determining compensation for assets transferred between the Bell operating assets and AT&T.

The importance of determining the fair value of the assets to be transferred cannot be overemphasized. In Pennsylvania it is estimated that approximately one-third of the present assets will be transferred away from Bell of Pennsylvania to AT&T. Since local rates are directly related to the assets retained by the operating companies, it is imperative that the assets retained are not directly or indirectly associated with providing services which are controlled by AT&T.

I believe that states should have substantial input concerning three primary areas:

(1) Determining which assets are to be transferred. There should be assurance that all of the assets concerned with the services to be provided by AT&T are transferred away from the local companies. The allocation methods

are complex and extremely controversial. If the methodology understates the extent to which "AT&T Services" utilize equipment, there is instant subsidy flowing from local ratepayers to AT&T. This occurs because state regulators must, by law, permit the local companies to collect their share of the investment through rates regulated by the state commission. Indeed, there have been some persuasive arguments that cross-subsidies already exist in the current method of allocating plants which work to the detriment of local subscribers.

(2) Determining the valuation of the assets to be transferred. Once a fair allocation method has been determined, it is important that AT&T be assessed the proper price for the assets. Obviously the most straightforward method would be to value the assets at net book value. There is some question as to whether this method accurately reflects the fair market value of the assets. If book values are to be considered, the correctness of the depreciation reserve becomes crucial. Since many states have simply adopted the FCC-prescribed depreciation rates, it becomes very important that states have the opportunity to comment upon the accrued depreciation utilized to value the assets. A more imprecise, but perhaps much fairer method, would be to value the transferred assets at fair market value or net book value, whichever is higher.

In Pennsylvania we have, until recently, recognized the "fair value" of utilities in determining rates, so determining market value does not seem to be an insurmountable obstacle to us. Our input may benefit all parties. In addition, it must be recognized that AT&T should reimburse local ratepayers for new products that have been under research and development and have been at least partially financed with local rates.

(3). Compensation. Since the assets to be transferred to AT&T have been at least partially financed by local ratepayers, it is important that any compensation be easily identifiable and recognized by state commissions in establishing local tariffs. It may be important, therefore, to require all compensation to be in the form and manner which can be recognized by the state commissions.

I note, however, that the actual impact of the pending settlement cannot be assessed until the AT&T devestiture plan is submitted. If the states do not have an opportunity to comment, the court will be deprived of any meaningful opportunity for effective review. I believe, therefore, that the comment period should be held open pending review of the plan itself. More specific comments can be entered by the states at that time.

NON-DISCRIMINATORY ACCESS CHARGES

H.R. 5158 provides for an access charge to be assessed upon all interexchange carriers that interconnect with the local exchange. The purpose of the access charge should be to ensure that intraexchange carriers are fairly compensated for the costs of distributing interexchange-telecommunications through the use of intraexchange services and facilities in order to ensure the continued universal availability of basic telecommunications service at reasonable and affordable rates.

Since the access charges will ultimately effect maintaining universal service at affordable rates, it is only reasonable to expect that these charges be subjected to state jurisdiction. Of course, the FCC or Joint Board may wish to propose certain guidelines for the states to follow.

Should the states gain exclusive jurisdiction over all exchange access charges, the legislation should give the states enough latitude to determine how the monies should be used. For instance, the charges could be used to mitigate against large increases to local subscribers as a result of the loss of subsidization by toll revenues. Without this latitude, access charges recoup only actual costs; thus it is conceivable that local basic rates may double or even triple.

Additionally, Commission discretion in setting higher access charges could result in greater contributions to the National Telecommunications Fund proposed in this legislation. Obviously the costs should never be set so high that users avoid the local loop altogether. This would only result in higher local rates and/or the ultimate deterioration of local services.

I respectfully request Congress to recognize the expertise of state regulatory agencies. The agencies, if given the authority, will act responsibly and within reasonable guidelines set by the FCC and/or Joint Board.

EXCHANGE BOUNDARIES

From the Perspective of a state regulator, jurisdictional boundaries should recognize the political entities in which the customer resides and to whom the regulators are responsible for the rates and service within the boundaries. Currently boundaries meet this criteria for the regulatory agencies exercising local exchange regulation as to rates and service. New developments in extended area of service (EAS), optional extended area service, and local community interest calling are keyed primarily to local and area services based upon political boundaries, such as police and fire protection, medical and social services, school districts and churches.

Similarly, state boundaries also meet this criteria for the present commissions responsible for intrastate toll rates within these boundaries. H.R. 5158 would rescind state jurisdiction over all intrastate tolls apparently based upon the weak justification that the intrastate toll operation is integrated with the interstate operation.

State commissions have proven to be highly capable of regulating intrastate interexchange services. There is no evidence to indicate that the state agencies will be any less capable of performing regulatory functions mandated by future legislation.

The states have the necessary staff and expertise to perform parallel functions of the FCC for intrastate interexchange carriers. The ability to evaluate the extent of competition in intrastate interexchange markets in order to determine when deregulation or continued regulation in some form is appropriate should be granted to the states.

The solution to this problem is to have the state retain intrastate toll jurisdiction under guidelines established by a federal-state joint board to ensure some uniformity.

The states should encourage competition and deregulation of carrier services in the intercity market when it will serve the best interest of the general public. States should retain the jurisdiction over intrastate toll services to the extent, and for the duration, that comparable services are regulated by the FCC.

Certainly, another important reason for the states to retain total intrastate jurisdiction is that the many optional EAS plans are largely related, at the present time, to the intrastate toll operation. In many areas these optional extended service plans are so universally used that the public equates them to universal basic service also. Transfer of intrastate toll jurisdiction to the FCC would, in many instances, make extended service and optional service plans so costly as to make them unaffordable to the public.

Regardless of the method employed for exchange boundary determinations, the provision of optional and no-optional extended calling arrangements to contiguous and nearby exchanges should continue to be wholly under state commission jurisdiction.

YELLOW PAGES

Yellow page revenues in Pennsylvania were $75 million net of expenses in 1980. Their loss to ratepayers would increase bills about $1.05 per month for most urban areas. The revenue loss would be somewhat less in the suburban areas.

Yellow pages are not a national interest. They primarily provide local advertising by local businesses or professions for local consumers.

Yellow page advertising is not a competitive service. The many rural areas in the Commonwealth will not constitute a prime market for nationwide competitors.

Yellow pages are a primary function of white page listings. Therefore, if yellow page revenues are phased out of state jurisdiction, then BOC's should be permitted to charge yellow page vendors for listings.

OTHER SERVICES

Under the Consent Decree the BOC's become primarily providers of dial tone. The market for dial tone is almost completely saturated. There is no reason to deny the BOC's opportunities for growth by permitting BOC's to provide, inter alia, centrex services, custom services and cellular radio systems.

INDEPENDENT ISSUES

Pennsylvania has 57 independent telephone companies. The impact upon the independents and their customers will be substantial. Their concerns relate to the impact of the new AT&T in their service territory and the unequal structure of the "new independents," namely, the BOC's.

The independents oppose any ability of AT&T to offer or resell "basic" services or to bypass the local network entirely. They believe that embedded telephone company terminal equipment should continue under state regulation, that the present level of access payments to telephone companies by other carriers should continue until parity is established and that legislation should provide payments to ensure reasonable rates for customers in sparsely populated rural areas.

Certainly, the impact of their concerns should be addressed in order for Congress to be assured of continuing rural telephone service.

In conclusion, Congress now has the unique ability to legislatively reaffirm the principle of universal telephone at affordable rates. The urgencies of rapid developments in telecommunications does not exempt us from continuing to evaluate the impact of competition, not merely the question of whether competition is feasible in this or that segment of telecommunications. The more basic question of the long term effects of these issues on the public at large is how it is likely to affect the adequacy, dependability and availability of telephone service and the price the public will have to pay for it. I say this because of your responsibility to the public at large, not to some customers but to all customers, and not only to today's public but tomorrow's as well.

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APPENDIX A

IMPACT OF DEREGULATION AND SEPARATIONS CHANGES UPON A REPRESENTATIVE INDEPENDENT PENNSYLVANIA TELEPHONE COMPANY *

The following figures pertain to only one Company (United Telephone) regarding the impact of deregulation and separations changes, but are probably representative of the industry.

General

1.	Number of Subscribers	217,971	
2.	Average Local Monthly Service Charges	Res. $9.03	Bus. $21.39
3.	Average Long Distance Monthly Charges per Main Station	$19.21	
4.	Average Charges for a Station Connection	$50.21	
5.	Total Station Connections per annum	$2,931,891	

Revenue Requirements (Monthly)

1.	Loss of Separations Support from Elimination of Toll	$3.24
2.	Loss of Separations Support from Deregulation of Terminal Equipment	$2.10
3.	Loss of Separations Support from Deregulating Inside Wiring	$1.91
4.	Loss of Support from Yellow Page Advertising	$1.00
	Total Monthly Revenue Requirement from Loss of Above	$8.25

Impact of Capital Recovery Changes

For this Company the depreciation expenses per annum would go from $19,500,000 to approximately $22,500,000 as a result of moving from straight line vintage grouping to equal life grouping and the use of the remaining life method of determining lives.

*Average local monthly residential service charges will approximately double.

Mr. **Wirth**. Thank you.

Mr. Rollins.

STATEMENT OF HENRY MOAK ROLLINS

Mr. **Rollins**. Thank you, Chairman Wirth.

I am one of three commissioners of the Public Utility Commission of Texas. Each of the other commissioners have read the materials which I have submitted and endorsed the comments which I am about to make.

I would emphasize comments of some of the other members here, that it is urgent that legislation address some of the issues which we have discussed this morning.

From the State point of view, we are looking at a Federal arena which presently involves a district court, it involves FCC actions which are continuing, it also involves the results of Senate bill 898 and the proposed legislation, House Resolution 5158.

All of those things impact us. It is only within the Congress that we can get a comprehensive plan put together that will address some of these issues.

I assure you that the FCC is proceeding head down and plowing along with its intended reorganization of the communications industry under its present authority under the Communications Act of 1934.

We have no relief from that activity except through your committee.

Part of those provisions would remove from our allocation authority and from our jurisdiction the intrastate toll services and the substantial revenues derived from there.

Other provisions terminate the longstanding agreement between the providers of local services and of intercity toll services under which the providers of local services have been compensated by the providers of toll services for the joint cost incurred in sustaining the local network.

Those settlements have been frequently characterized as a subsidy of the local service, a description I believe is incorrect.

For purposes of illustration, let us assume that we, as State regulators of local services, were to prohibit the interconnection of the intercity linkage to the existing local services.

The result would be that the toll services would have zero revenues until that time when they could build new and duplicative local networks for which the intercity companies would have to make substantial charges in addition to their toll services in order to sustain their own investment, maintenance, and service cost for a local network.

Without a local network on each end, there is no toll revenue. And there are no toll companies.

The economically appropriate access charge for the use of the existing local network is 1 cent less than it would cost the toll services to create and maintain a duplicative local system.

The existing system has grown through the joint provision of local calling and intercity calling on a single local network, through the sharing of joint costs.

Federal actions now propose to dismantle that joint system and to give all of the providers of intercity linkage unrestricted access to the local networks.

The compensation for the provision of the essential local network is to be accomplished by an undefined access charge.

I would urge that the access charge be legislatively prescribed to insure that the revenues available to the local networks be no less than the revenues provided from the present settlement agreements and to provide some incremental compensation to the local networks as intercity services increase.

In Texas, we have an unusual situation shared by the States of Florida and California, and to a lesser degree by a few other geographically large States, in that we have several urban population centers within one State, which are separated by several hundred miles of low-population density.

In Texas, we have 3 of the 10 most populous cities in the United States, Houston, San Antonio, and Dallas. Each of these population centers is more than 200 miles from the other two. At the far extremes of the State, more than 800 miles apart, El Paso on the west and the Beaumont SMSA on the east, have populations in excess of 400,000.

At the far south, the two SMSA's of the Rio Grande Valley, with a total population of 500,000, are offset by Amarillo and Lubbuck in the Texas Panhandle with a population of 200,000 each.

These are so widely separated that there is a very large intrastate toll revenue which has made a significant contribution to the joint costs of operation, even though the average per mile, daytime toll rates set by my commission have been generally comparable to the average per mile, daytime toll rates set by the FCC for domestic interstate toll services.

In the small communities which dot the map between the large population centers and the rural agricultural and ranching areas, local service is an essential of life. When you live 10, 20, or 40 miles from the closest crossroads town, local telephone service is not a luxury, it is your principal link to medical services, to business associates and suppliers, and to distant family and social contacts.

It is a very necessary tool in the commerce of food and fiber primary producers. The operation and maintenance expenses of such low-density telephone systems are necessarily high and the investment per subscriber is similarly disproportionate of that of the more densely populated cities.

If this essential service is to be maintained at a reasonable price and if we are to insure the principle of universal service so that there will be effective local networks with which the toll services may interconnect, there must be a recognition in the access charge formulation of the special problems of low-density, high-cost systems, serving small communities and rural areas.

I offer the data and tables attached to my comments, as illustrative of the problems imposed on State regulators by several of the actions contemplated.

Table 1 gives us a general overview of the companies which we regulate. While Southwestern Bell operates approximately 4 of every 5 telephones in the State, 73 independent telephone companies serve more than half of the 250,000 square miles of certificated service territory.

It is obvious that these independent companies' customers are often widely dispersed geographically. One of those independent companies serves an area of 18,000 square miles in which it has only 2,100 customers.

Of the 73 independent companies, 33 have estimated 1981 operating revenues of less than $1 million each. It is our belief that many of these companies simply would not survive under some of the presently proposed changes.

We urge that these companies, which serve widely dispersed rural customers, be considered carefully in your deliberations.

Table 2 demonstrates the financial impact on local exchange rates of a representative sample of small companies with estimated operating revenues of less than $1 million a year.

The impact may be best illustrated by beginning at the bottom and working up through the tables. In each case, it can be seen that the resulting local basic access rates which are already relatively high for these companies, could increase to more than 200 percent of the present levels. In one instance, to 310 percent.

Such prospective impacts threaten the universal service concept and the very survival of telephone service in a large portion of our State.

Table 3 shows that financial impact on local exchange rates is not limited to just the smallest companies. In this table data we presented for the two largest companies in our State and for several midsize companies.

Again, the impact on rates for local services is severe, ranging from 172 to 287 percent of present rates. An access charge that recognizes the special problems of Texas and of those other States which have large interstate toll services is essential to the continued vitality of our telephone industry and to the continued ability of Texans to afford telephone service, no matter where they live, or where they work.

The present system has been effective through State regulation of intrastate tolls. You in the Federal Government seem determined to dismantle that system and to appropriate to the Federal regulatory level the investment, the revenues, and the services associated with the intrastate toll networks and to appropriate to an unregulated arena the investment and revenues associated with customers' premises equipment.

I must urge that in that transfer of assets from the local operating companies, fair compensation be provided so that the local ratepayers are not saddled with an inordinate amount of nonproductive investments in the residual rate base.

The opportunities for abuse of local rate bearers in this process must be closely monitored to insure equitable treatment.

I cannot conclude my remarks without addressing one other impending abuse of local ratepayers, the removal of local directory advertising revenue from the allocation jurisdiction of State regulatory bodies and correspondingly from the support of local services.

It is beyond my comprehension that anyone can say the revenue from advertising in the local telephone directory which must be furnished as an integral part of local telephone service is somehow separate from the revenues of the local telephone operating company.

Advertising is physically within the directory book in all except the largest cities. The advertising is meaningless without the listing data which must be provided by the local telephone operating company.

The plan to remove these local revenues from the allocation jurisdiction of State regulatory commissions is in my opinion indefensible.

In conclusion, I wish to compliment Chairman Wirth and the members of the subcommittee staff for the thoughtful consideration shown in drafting H.R. 5158.

Most of the concerns I have expressed in these comments are accommodated or mitigated through provisions of this bill. Those provisions include State regulatory inputs into access charge determination, support for high-cost, low-density rural systems and establishments of a rational transfer pricing.

Even if all of these accommodations are retained in the bill finally adopted by the Congress, the combined actions of the FCC, the Federal courts and the Congress will impose upon State commissions the unpleasant obligation to raise local telephone service rates even more sharply than recent annual increases caused by operating costs.

Only Congress can structure a well-designed comprehensive solution to these issues if, despite Mr. Luken's assessment, the Congress can act.

I can tell you from bitter personal experience that there is an impending widespread citizen uprising against higher local telephone rates. To the extent I can, I intend to divert that anger away from State public utility commissions and direct it to the elected Members of the Congress of the United States as the parties most responsible.

Thank you.

[Attachments to Mr. Rollins' prepared statement follow:]

TABLE I

STATISTICAL HIGHLIGHTS OF THE TEXAS TELEPHONE INDUSTRY

General Characteristics

Total number of local-exchange companies:	74	
Number of companies with less than $1 million in Annual Operating Revenues (1981 est.):	33	
Total telephones served by Texas companies:	11,531,000	
Telephones served by Southwestern Bell:	9,212,600	(79.9%)
Telephones served by independent companies:	2,318,400	(20.1%)
Telephones of companies under $1 million:	44,500	(.39%)

Breakdown by Texas Operating Revenues

Classes B, C and D (less than $250,000):	11 companies
Class A (greater than $250,000):	63 companies

Subcategories of Class A

($250,000-$1,000,000):	22
($1,000,000-$5,000,000):	27
($5,000,000-$10,000,000):	6
($10,000,000-$100,000,000):	6

General Tel. Southwest	> $500 million
Southwestern Bell	> $3.8 billion

Breakdown by Number of Total Telephones

0-1,000 telephones	13 companies (smallest: Knippa Tel. Co., 264 telephones)
1,000-2,500	20 companies
2,500-5,000	11 companies
5,000-10,000	12 companies
10,000-50,000	13 companies
Subtotal	69 companies

others:

Central Telephone Co. of Texas (100,393)
United Telephone Co. of Texas (133,528)
Continental Telephone Co. of Texas (186,726)
General Telephone Co. of the Southwest (1,440,000)
Southwestern Bell Telephone Co. (9,212,644)

TABLE II

POTENTIAL EFFECTS ON LOCAL RATES (SMALL COMPANIES)

	Brazos Coop.	Industry Tel. Co.	Lake Tel. Co.	Santa Rosa Coop.	Alto Tel.
Loss of interstate separations support from elimination of toll contributions	$ (32,695)	$ (48,368)	$(43,390)	$ (54,943)	-
Loss of intrastate separations support from elimination of toll contributions	$ (71,987)	$(148,075)	$ (8,743)	$(127,208)	$ (62,079) ***
Loss of separations support from detarriffing of CPE	$ (8,977)	$ (31,161)	$(36,184)	$ (17,382)	$ (59,046)
Loss of Yellow Pages contribution	$ *n/a	$ (5,603)	$ *n/a	$ (1,613)	$ (4,177)
TOTAL Revenue Requirement Effect	$(113,659)	$(233,207)	$(88,317)	$(201,146)	$(125,302)
Percent of Total Revenues	36%	57%	27%	21%	28%
Number of Customers	1,031	986	580	1,324	1,253
Resulting average monthly increase in local rates due to loss of interstate and intrastate toll separations support.	$ 8.46	$ 16.60	$ 7.49	$ 11.47	$ 4.13
Resulting average monthly increase in local rates due to loss of CPE separations support.	$ .73	$ 2.63	$ 5.20**	$ 1.09	$ 3.93
Resulting average monthly increase in local rates due to loss of yellow pages contributions	$ n/a	$ .47	$ n/a	$ .10	$ .28
Present average monthly residential local rates	$ 8.35	$ 9.38	$ 7.10	$ 9.18	$ 6.10
Potential residential local rates	$ 17.54	$ 29.08	$ 19.79	$ 21.84	$ 14.44
Ratio of Potential Residential Rates to Present	210%	310%	279%	238%	237%

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* Company has no Yellow Pages revenue
** Includes mobile
***Includes loss of separations support from Interstate Toll

TABLE III

POTENTIAL EFFECTS ON LOCAL RATES (LARGE AND MEDIUM SIZE COMPANIES)

	Southwestern Bell	General	Kerrville	Comanche County	GVTC	Sugarland
Loss of interstate separations support from elimination of toll contributions	$(183,765,000)	$ (56,494,000)	$ (361,143)	$ (101,453)	$ (324,474)	$ (786,863)
Loss of intrastate separations support from elimination of toll contributions	$(267,306,000)	$ (58,826,000)	$ (499,987)	$ (289,562)	$ (751,462)	$ (373,790)
Loss of separations support from detarriffing of CPE	$(187,813,000)	$ (19,041,000)	$ (362,523)	$ *	$ (171,138)	$ *
Loss of Yellow Pages contribution	$(173,000,000)	$ (7,100,000)	$ (114,261)	$ N/A	$ (62,959)	$ N/A
TOTAL Revenue Requirement effect	$(811,884,000)	$(141,461,000)	$(1,337,914)	$ (391,015)	$(1,310,033)	$(1,160,653)
Percent of Total Revenues	24%	35%	30%	32%	34%	19%
Number of Customers	4,293,098	737,716	10,002	5,654	7,968	7,833
Resulting average monthly increase in local rates due to loss of interstate and intrastate toll separations support	$ 8.76	$ 13.03	$ 7.18	$ 5.76	$ 13.35	$ 12.32
Resulting average monthly increase in local rates due to loss of CPE separations support	$ 3.65	$ 2.13	$ 3.02	$ N/A	$ 1.80	$ N/A
Resulting average monthly increase in local rates due to loss of yellow pages contributions	$ 3.35	$ .80	$ .95	$ N/A	$ .66	$ N/A
Present average monthly residential local rates	$ 8.40	$ 10.65	$ 7.40	$ 8.00	$ 8.75	$ 10.25
Potential residential local rates	$ 24.16	$ 26.63	$ 18.55	$ 13.76	$ 24.56	$ 22.57
Ratio of Potential Residential Rates to Present Rates	287%	250%	251%	172%	281%	220%

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*Loss of separations support from the detarriffing of CPE is included in the elimination of toll contribution calculations.

N/A - Not Available At This Time

ACKNOWLEDGMENTS

We wish to express our sincere appreciation for assistance in collection and preparation of the data contained in the attached tables to Mr. Conley Cathey, Director of Southwest Operations, John Staurulakas, Inc. and Mr. Vaughn Aldredge, Executive Director, Texas Telephone Association, Inc.

Mr. WIRTH. Thank you very much, Mr. Rollins.

Another way of saying that, perhaps, is that a concern which has been put into sharp relief by the settlement on January and has put wind in the sails of this legislation that all of us have been working on for a long time.

It is certainly my hope that these issues help to provide the momentum necessary for the kind of comprehensive legislation that has been, in the past, supported very aggressively by all parties. Even A.T. & T., supported legislation, stating said that only Congress could address these issues.

I hope that that concern that you were talking about does help us pass this legislation very expeditiously.

Mr. Schneider.

STATEMENT OF THOMAS J. SCHNEIDER

Mr. SCHNEIDER. Chairman Wirth, I deeply and personally appreciate your efforts in letting me appear as a late addition to the original roster.

I want to preface my remarks by saying I am one of five elected commissioners in Montana. We have a general reputation among Mountain Bell and A.T. & T. concerns as being very aggressive. I think they would say hostile.

I don't agree with that, but I can tell you we certainly agree with the aggressive evaluation. I think areas of concern have really been hashed out extensively this morning.

I can guess that you are getting rather exhausted and there has been some repetition.

I would like to focus my comments on one specific area, and that is the access charge. I think there is a viable mechanism readily apparent and easily includable in your bill that will, to a great measure, eliminate many of our concerns and fears about the whole access issue.

And that is the simple recognition of State jurisdiction directly over access charges. I will attempt to demonstrate that that position is entirely consistent with the philosophy and purposes you have established in your bill, is local, is necessary, is administratively feasible and has the built-in balances that protect against punitive or barrier-type access charges.

Those comments are outlined in the attachment to the testimony I submitted. Many people did not get that in the original packet. I only this morning got that prepared.

First, consistent with the purposes of the bill, certainly it is consistent with the universal service availability and very much consistent with your recognition in the purposes that the regulatory expertise of the States ought to be fully implemented.

It is next logical and necessary because the cost associated with providing that basic exchanges facility, those local loops on both ends, are very site specific. The nationwide averaging techniques envisioned in most of what has been talked about, I think, are entirely inadequate in addressing particularly the concerns of the rural West.

The specific cost must, in any event, be determined by the States in evaluating this skeleton of the essential exchange that is left under the proposed consent decree.

The determination of the access charge then simply becomes another element in the cost of service/rate design scenario that we live with on a daily basis in telecommunications, electricity, and natural gas.

It is not unique. It is not anything that we cannot handle with some degree of expertise.

It is next very administratively simple. It is a direct method of providing the availability and substitution for the separations process—I think a much better way than the existing separations process.

Each State would simply establish its access cost based on those local basic exchange costs, specific to the site in the State.

Two access charges would be available and present in each interstate call. That is, the call from Montana to Rhode Island, and vice versa, would simply contain, be built into the tariffs and an access charge at each end.

That is neither complicated nor any inhibition on interstate traffic. It is technologically simple in terms of the computerized electronic switches that are available. Even the cross-bar switches will permit this kind of billing without any major difficulties at all.

It replaces the very cumbersome—a very unsatisfactory separations process, which I think penalizes again the people on the end of the line, the people in States like Colorado, Idaho, Montana, South Dakota, and so forth.

It avoids a similarly complicated and burdensome rebate or telecommunications fund approach. I think it is far more direct, it is more administratively simple and I think it will more directly reflect those individuals' costs.

Finally, to those who would argue that State jurisdiction will generate barriers and result in States levying unfair and punitive access charges, I would submit that there are very strong balancing mechanisms to inhibit that tendency.

The FCC, A.T. & T., and any toll carrier that would be connecting to the basic exchange would have full rights of intervention, presentation of effort, of evidence and court relief if they determined or felt that it was an unjust invasion, either of cost or interstate commerce.

Each State commission in its own self-interest has a very dramatic and continuing responsibility to tollpayers.

These same ratepayers in Montana and Rhode Island are also going to have to pay the toll charges. To the extent that the access is a burden to those, these are the same people. But I think it fairly recognizes the basic exchange service as being a lifeline.

Finally, the loss of access revenue through bypassing of the local exchange system is a very real incentive, not to inflate the basic exchange access charges that we would be setting.

A.T. & T.'s Mr. Brown, in his testimony—in broad coverage of that testimony, has indicated very clearly that he believes any punitive or inflated access charges would result in precisely that (bypassing the local exchange).

So this proposal for State regulation of access, I think is a workable one, it must be viewed in terms of the other comments I have contained within my testimony as to what is the determination of "regulated" versus "unregulated," and the determination of exchange boundaries, to insure that the interexchange network remains available in those isolated communities that are never going to have access to alternative service.

Again, on behalf of the Montana Commission and the State of Montana, I want to express my deep gratitude for this late entry and we intend to work very aggressively with the consortium of States in helping you to sort this out.

Thank you, Mr. Chairman.

[Mr. Schneider's prepared statement follows:]

Subcommittee on Telecommunications,
Consumer Protection and Finance

H.R. 5158

•OUTLINE OF COMMENTS

MONTANA PUBLIC SERIVCE COMMISSION

By: Commissioner Thomas J. Schneider
February 2, 1982

STATE JURISDICTION ACCESS CHARGES

State jurisdiction of exchange access is consistent with purposes of Bill 5158, is logical, and is administratively feasible.

I. CONSISTENT with PURPOSES OF BILL

(1) "to make available to all the people of the United States efficient nationwide and worldwide telecommunications at reasonable and affordable charges."

(10) "to encourage cooperation between the Federal Government and the States in regulating telecommunicatons carriers, to recognize the appropriate jurisdictional authority of the States, and to utilize effectively the regulatory expertise of State Commissions."

II. LOGICAL and NECESSARY

A. Costs associated with access are site specific.

B. Nationwide averaging will mask these cost differences.

C. Specific costs must be determined by the States for the exchange facilities in any event; determination of the access charge for toll service is simply an element in rate design.

III. ADMINISTRATIVELY SIMPLE

A. State determination of access charges is a DIRECT method of dealing with the PURPOSE of "universal service at reasonable and affordable charges."

B. Each State would establish exchange access charge(s) which are then given RECIPROCITY by the other States. Two access elements will exist on each call (i.e., Montana to Rhode Island).

C. Implementation of this billing mechanism, which reflects published tariffs, is technologically simple given the computerized feature of modern electronic switches.

D. Such direct access cost determination replaces an extremely cumbersome Separations Process.

E. Such direct access cost determination avoids similarly complicated and administratively burdensome concepts like the National Telecommunications Fund.

IV. SEVERAL STRONG BALANCING INCENTIVES WILL EXIST TO INSURE AGAINST PUNITIVE OR UNJUSTIFIED ACCESS CHARGES

A. The FCC, AT&T, and other toll carriers will, of course, have full intervention rights in the State determinations

(1) EVIDENCE

(2) COURT REVIEW (PURPOSES OF ACT)

B. Each State Commission in its own self interest will retain current concerns about the level of toll charges (including access) because it is the same local ratepayers who will be affected. Access simply becomes another, albeit crucial rate design issue, which requires a balancing of costs and policy.

C. Potential loss of access revenue through by-passing of local exchanges. Refer to Statement of Charles Brown, AT&T.

Subcommittee on Telecommunications,
Consumer Protection and Finance

Hearing: H.R. 5158, February 2, 1982

Testimony
of the
Montana Public Service Commission

by

Commissioner Thomas J. Schneider

Chairman Wirth; Members of the Subcommittee:

I am Tom Schneider, one of the five elected members of the Montana Public Service Commission. I want to personally thank each of you and the Subcommittee Staff for allowing me to testify on this matter of crucial national concern.

I wish to preface my specific comments with a "qualifying" remark about the philosophy and practice of the Montana PSC. I can state with some confidence that AT&T and Mountain Bell view the Montana PSC as a hostile and aggressive regulator flowing from major confrontations on key issues: double leverage, capital structure, license contracts, Bell Labs trade secrets, and cost of service and rate design. We continue to make every attempt to insure that the specialized competitive services bear the full costs associated with those services (from research through provision of service). That approach is critical in order to avoid monopoly cross subsidization of competitive products and concurrently to assure viable and fair competition.

That Montana philosophy is entirely consistent with the purposes contained in this Bill. Given the proposed antitrust settlement, the need for a definitive national policy on telecommunications is urgently needed. The people of the United States through their elected representatives deserve no less. The Congress of the United States must not allow national telecommunications policy, to occur by default to any future antitrust settlement between the Department of Justice and AT&T. Provided below is an outline of several specific recommendations relative to H.R. 5158 and a separate outline with additional detail on the issue of State jurisdictional access charges.

Specific Areas of Concern

and

Recommendation on H.R. 5158

I. Inject wherever possible the basic philosophy of setting specific national goals and purposes giving real administration and implementation to State regulators where possible. The best example I know of this technique occurred in the Public Utility Regulatory Policies Act of 1978. The results have been very positive and progressive.

II. State jurisdiction over access charges is consistent with the PURPOSES of H.R. 5158, is logical, and is administratively feasible. (See more detailed Outline on this issue that is attached.)

III. We support the specific section by section comments of the North Dakota PSC of January 21, 1982, as a good examination of areas in which State expertise and jurisdiction may better serve the Purposes of H.R. 5158. Those comments serve as a good staring point for establishing the respective State/FCC/JT Board jurisdictions.

IV. Determination that "no alternative service exists" is clearly and logically a local site specific matter over which each State must have control. This concern is closely tied to V.

V. Determination of "regulated" and "unregulated" must rest with States, since it is the site specific availability of real competition which must be considered. Extreme danger exists for possible abandonment of low traffic, high cost toll routes which are prevalent in rural areas. (i.e., railroads, airlines, trucking.)

VI. Determination of exchange boundaries must logically rest with the State Commission(s). The various configurations which exist with respect to extended area service, locality rate area, centralization plans, etc., make it vital that flexibility exists in exchange determinations. This is also particularly crucial for the multiple small exchanges which currently exist under the Bell Companies. Statewide exchanges or some logical increment of a State may be the exchange unit which best solves the ACCESS matter with the minimum adverse impact. Simply put some grouping and averaging of exchanges is logical and necessary. Eliminate date (January 1, 1982) for grandfathering and vest authority with States subject to Joint Board review.

VII. Regional hearings on this crucial rewrite of national policy are very important. Grass roots input by the Commissions, Consumers, and Consumer or Public Counsels is particularly vital in the rural states of the West. I would suggest Salt Lake City as a central and accessible location.

The Montana PSC is committed to work with other states and the Subcommittee and its Staff to develop this vital national policy. Montana expects to join South Dakota and several western and mid-western states in filings before Judge Green and before Congressional Committees. The days of telecommunications apathy on the part of State PUC's are past. The Montana PSC particularly appreciates the consideration shown the States in your efforts on H.R. 5158. This bill provides a vehicle to implement positive changes in national telecommunications. If the valid concerns expressed here today are integrated into this Bill, the nation will be well served.

Mr. Wirth. Thank you, Mr. Schneider. We have heard this morning from a large number of geographically dispersed States, and you mentioned, I believe, Mr. Rollins, one telephone company in your State of Texas which covers 18,000 square miles with 2,100 subscribers.

To make that more dramatic, I might point out that that telephone company's area of 18,000 square miles which has 2,100 subscribers is larger than the States of Connecticut, Delaware, New Hampshire, New Jersey, Vermont, Maryland and, of course, the District of Columbia.

You can imagine the kind of diversity we have to think about. I think this illustrates more clearly the need to build in and develop a certainty for not only that very, very large district with only 2,100 subscribers, but such States as California, Pennsylvania, Colorado, Kansas, Montana, and so on, where we have as you point out, these very large SMSA's and some very broadly dispersed geographical areas where we have to develop a certainty there, and I don't see any way we can do that other than through legislation.

Mr. Rollins. I agree.

Mr. Wirth. Does everybody agree with that?

Mr. Loux. Yes.

Mr. Schneider. Yes.

Ms. Miller. Yes.

Mr. Wirth. Did you all agree with the previous panel that we can't take the other two choices, the second choice being to wait until after all of this is through and the third to do no legislation at all?

Ms. Miller. I would suggest that it is even more necessary now in view of the settlement. I think it is absolutely essential. What we have is a broad-brush plan, but no details. With details to be submitted down the road and there is some ambiguity, apparently, as to when that submission is supposed to take place.

I think in the absence of legislation, there is going to be enormous uncertainty and we will, in effect, be approving something that we don't know the details of, and it is the details that are going to fill in exactly what those cost increases are going to mean and the other kinds of impacts upon daily living that the plan will have.

I think legislation absolutely is essential there.

Mr. WIRTH. The response we got last week to the question of details, evaluation, and so on, was in effect, trust me.

Ms. MILLER. Faith has its limits, I think.

Mr. LOUX. I think, too, you have to remember that that is public policy being made, and it is—the place for that is the Congress, not with A.T. & T. and the Justice Department.

Mr. WIRTH. We have already heard that argument now for 6 years, that is, it is the Congress that should be setting policy and I intend to continue believing that.

Mr. ROLLINS. I would suggest, Mr. Wirth, not only is the court acting, the FCC continues to act, they are setting policy, they are setting the future of the communications system.

They are doing so under the authority given them under the 1934 act. They are planning ahead, presumably with the assumption that there will be no legislation.

And the impact that some of those rulings will have will be very severe upon the authority and the ability of State commissions to deal with some of these problems we have discussed.

Mr. WIRTH. These problems do go far beyond the resolution of the issues in the settlement, which is really an antitrust issue.

What we have done is approach the resolution of one issue, which is the relationship between the local operating companies, and long distance, and Western Electric.

There are a whole series of other ones which have been discussed very thoroughly this morning and have to be addressed.

What is going to happen in the transition from monopoly to a more competitive environment has to be looked at and done in legislation. Does everybody agree on that?

Mr. LOUX. Yes.

Ms. MILLER. Yes.

Mr. YORK. Yes.

Ms. SHANAMAN. Yes.

Mr. WIRTH. I understood that that was the unanimous consensus of everyone that attended the NARUC conference. I would like a comment on the relationship of the new A.T. & T. between its Bell Long Lines, a regulated entity, and Western Electric and Bell Labs, which are unregulated.

Now we have discussed, and many of you have testified over the years about avoiding cross-subsidies from the regulated entity to the competitive one.

I believe, Mr. Loux, in your testimony this morning, you touched on it briefly. Is that an issue we should be worried about, and if so, why and how?

Mr. LOUX. Well, our experience has been that where you have monopoly services also being performed by the same company with nonmonopoly services, there is a great tendency for cross-subsidization.

That is the reason in my testimony that we suggested that separate subsidiary be formed, just for regulated toll services, if that was going to be the direction, to prevent cross-subsidization, where you have common facilities, common personnel, common R. & D., and you could go on and on.

There is a great tendency for cross-subsidization.

Mr. WIRTH. Anyone else like to comment?

Mr. YORK. I would like to comment in two different directions. One is that I have been puzzled by the absolute insistence that the local operating company not be involved in competitive business because of the danger of cross-subsidization and that sort of thing. Yet there is quite a willingness to allow the national companies to be somehow together in a way that Pete has just referred to.

The other concern that I have in this area is the problem if you allow A.T. & T. to make all of the judgments about how the telephone industry will be structured, with the sole exception of the antitrust considerations that the Justice Department has been pursuing—I am not arguing about them pursuing it.

If you say, OK, Justice will force these antitrust considerations, A.T. & T., you go and structure the whole rest of the industry, which is the way we read the settlement agreement, you have left a vacuum that takes the one real competitor to A.T. & T. out of the marketplace, the local operating company, and you have left A.T. & T. with a dominant position in that marketplace with no viable answer in the near future.

I am talking CPE now, as opposed to the data communication and long distance-type of things which are apparently a serious concern of the Justice Department.

We are very concerned that what happens on the national level will have a counterpart on the local level in terms of the breakup of these entities.

Mr. WIRTH. Mr. Schneider?

Mr. SCHNEIDER. It just seems to me that it is apparent on its face that the proposed settlement of the antitrust case broke down in that regard. The talk for many, many years was that if there was going to be a break, it would be the break between regulated and unregulated, rather than this hybrid where the regulated elements of long distance go with the Bell Lab and the Western Electric.

It just seems to me there is a fundamental breakdown in the process itself. So it seems to me the appropriate Justice procedure now would be to move to correct that element in the antitrust settlement.

But on a more basic level, the question of subsidy among regulated and unregulated is probably the issue that has identified us as being a hostile Commission.

We have dealt with the licensed contracts, with the Bell trade secrets issues, the capitalization issues. We know it is there and it sure as the Devil is not going to disappear the way it is broken now.

Mr. WIRTH. Let's now turn to another issue that has been much discussed this morning: The Yellow Page issue. As I read the settlement document, the Yellow Pages moves from the BOC's to the parent 18 months after the 6-month period.

Is that how you all read the settlement document as well? That the Yellow Pages moves to the parent company?

Ms. MILLER. Yes.

Mr. Wirth. Mr. Brown sent a letter to Senator Packwood, which some of you may have seen, saying that there would not be a move in 18 months, but that it would be done over a 4-year period of time.

Have you all seen that correspondence?

Mr. York. No.

Ms. Shanaman. No.

Mr. Wirth. As a matter of record, he pointed that out to us last week. How can we decide that we have come to a settlement agreement but then have a change made in that settlement with regard to Yellow Pages?

Does that suggest, also, that A.T. & T. will be able to make changes in how customers' premises equipment is treated, or that they can spinoff only half of the Bell operating companies?

I am not clear. Either you have a settlement or you don't. Do you have any——

Mr. Rollins. I would suggest that surely within the authority to judge, he can take modification of that settlement agreement and accept them or disapprove them.

A settlement agreement has been submitted in the present form, one supplemental agreement has been submitted, I would suggest that there would be other supplements to the judge.

He will be making the final decision as to whether those supplements will be accepted or not. I would hope that some of those supplements would reflect inputs from public and from the various State commissions in the hearings process, which the judge presumes to have.

Mr. Wirth. Do you all believe that that 4-year transition referred to by Mr. Brown in his letter to Senator Packwood is sufficient in dealing with the Yellow Pages?

Ms. Miller. I disagree very strongly. I would prefer 4 years to 18 months, but it seems to me that Yellow Pages advertising is an essential part of basic service. What gives it its value is the local listing. What gives it its value is the ability of the Bell System to get that advertisement into almost every home. In Colorado, 95 percent of the homes have telephones and virtually every business in the State.

This is what gives it its value. It is the basic exchange service. It seems to me those revenues should adhere in basic exchange service.

I prefer 4 years to 18 months. I see no reason why those revenues should be divorced from local service at all.

Mr. Wirth. The argument was made last week that Yellow Pages is a competitive service.

Ms. Miller. I don't see Yellow Pages as a competitive service at all.

Mr. Wirth. There is not more than one Yellow Pages?

Ms. Miller. If there is, I have not seen it. Which would seem to me to mean that it is not very widely distrubuted.

Mr. Wirth. If it is not a competitive service, it is difficult to theoretically make the argument that, therefore, you ought to move the company to the competitive entity. Consistency is not necessarily the mortar stone of politics, but we must recognize the reality of the underlying level of competition with respect to Yellow Pages today when we deal with this issue.

Mr. **Rollins**. I would comment even if it were competitive, and set the price wherever the competitive market requires it to be set, the revenues still belong to the local company.

Mr. **Wirth**. Did you hear the figures that were given this morning by Florida?

Mr. **Rollins**. Yes, sir, we did. We have a corresponding figure for Texas if you would like to hear it.

Mr. **Wirth**. You are anticipating the very question, Mr. Rollins.

Mr. **Rollins**. With Southwestern Bell, the loss of Yellow Pages' contribution would be $173 million per year. For General Telephone, of the Southwest, $7 million per year, and with the smaller companies, the nature of the revenues is much less.

Mr. **Wirth**. There was also discussion, Mr. York, in your testimony, about the difficulties of reaching consensus and the fact that in working through this legislation over the next months there would be sharp disagreements.

What are those sharp disagreements?

Mr. **York**. It seems to me the interests of the surviving A.T. & T. Co., under the settlement agreement, are sharply divergent from those of the surviving local operating company.

Any kind of structuring that you do on a national level, which either is consistent with or overrides the conditions of the settlement agreement, is going to have two groups in opposition.

The illustration of that is the point you have heard over and over about conflict of interest on the part of operating company people who today don't know whether they will be with A.T. & T. or the operating company after the split and are in no position to take the operating company's point of view over against A.T. & T. while they are A.T. & T. employees.

So, we see those kinds of things happening.

Mr. **Wirth**. Who is speaking for the operating companies?

Mr. **York**. At the moment, A.T. & T., which is hardly representative.

Mr. **Wirth**. You are talking about there being a conflict. If A.T. & T. is speaking for the companies, how can there be a conflict?

Mr. **York**. Because we see the ultimate interest of the surviving operating company as being substantially different from the interests of A.T. & T.

Take the question——

Mr. **Wirth**. If they are already speaking for the operating companies, how do the operating companies' interests get reflected in the discussion?

Mr. **York**. That is exactly the point, they are not. We are the only ones that, as far as I know, are taking that position.

Mr. **Wirth**. Why can't A.T. & T. speak for the local operating companies?

Mr. **York**. Because we believe that the interests of the A.T. & T. stockholder ultimately are going to be in the A.T. & T. surviving company, not in the operating company. We see the operating companies as being the poor stepchildren of the whole thing. At the point of divestiture, the amount of value in the stock for both

A.T. & T. and the operating company are the same. So the A.T. & T. shareholder at the point of division is not affected.

But after the division, the value of one stock as we see it is going to go up and the value of the other stock is going to go down. We do not see anybody besides ourselves—that may be why we have the unanimity among ourselves we have, we do not see anybody else representing that interest which ultimately is the monopoly ratepayer interest.

Mr. LOUX. Additionally, you have the problem of the divergent interest of the shareholders of the surviving BOC and the ratepayers, the users of the BOCs. While a shareholder of A.T. & T. may get another piece of paper showing an interest in a BOC, and the division of interest and evaluation of assets may not be too important, but it is important to the ratepayer.

If the ratepayer money has been used or transferred away to—not being dedicated to his use, then he is going to have to supply more money, more capital, through increased rates, to make the company whole.

So it is not only a conflict between the shareholders of the BOC and A.T. & T. but it is a conflict between the ratepayers and the BOC's shareholders.

Ms. MILLER. One additional conflict that perhaps should be brought out is the fact that management of the BOCs, at this moment I would suggest, have divided loyalties. Rationally one would expect it to be with the local system but as was pointed out, they are still employees of A.T. & T. and in addition to that, habits of a lifetime die hard. These people have been reared in the Bell tradition and the tradition is one of loyalty to the parent company.

Mr. WIRTH. There is also in the Bell tradition a great loyalty to provide local service at a price that people can afford, which has been one of the enormous contributions made by the Bell System. Now what happens to that characteristic, which we have all come to respect and expect in this country?

Ms. MILLER. My suggestion is that the Bell employees at the local operating companies, at present, have divided loyalties. I suspect they do not know which to put first, the interest of the parent company or the interest of the local system. It is a very difficult position they are in.

Mr. YORK. Let me suggest a specific example of the divergence. For the purpose of divestment, do you value property at fair market value or net book? It depends where you sit after the divestment takes place as to which way you want it to go.

Do you have it go first to the existing 22 operating companies and then spin off the new local exchange company and divest to that or do you go the other way around, spin off the present company and divest the CPE and so forth back to A.T. & T. as you have heard suggested this morning? There are very significant value and dollar differences in the end result depending on which of those approaches you take.

Mr. WIRTH. As I understand what you are saying, Mr. York, in addition to the issues of access charges, terminal equipment, and yellow pages, there is the issue of how much more the ratepayer would be paying if the assets in the operating company are transferred either inappropriately to the parent company or are transferred at too low a value. Could that cost the customers even more than the numbers you have been talking about so far today?

Mr. **York**. Yes, I would suggest there is a way to test my theory. Both A.T. & T. and Justice say it is a wash, it does not make any difference. I say fine, if it is a wash, do it my way, and I would be willing to guess what the reaction will be.

Mr. **Wirth**. Mr. Schneider.

Mr. **Schneider**. Chairman Wirth, it is not only even in the evaluation or valuation and transfers of assets. It goes to capital structure; it goes to the assumption of existing debt and other very significant difficult financial issues, even apart from valuations. So that is an area that I do not think anybody is talking very much about; but I have some confidence that that might be the sleeper in the whole thing.

Mr. **Wirth**. Let me ask you a final question, if I might. Let's assume for a minute that there is somebody speaking on behalf of the local operating companies and presumably they would be pretty much in agreement with the position you all take.

Ms. **Miller**. Hopefully.

Mr. **Wirth**. Would they be pretty much in the position of advocating legislation?

Mr. **York**. I suspect there is one point of divergence. A regulated utility is likely to seek less stringent regulation than we might seek and there might be a divergence.

But in the issues——

Mr. **Wirth**. So while they would see the need for legislation, they might disagree with you all on H.R. 5158 in terms of simplification of the FCC and diminution of the FCC's regulatory authority.

Mr. **York**. But up to that point, yes, I would agree.

Mr. **Wirth**. Getting to the point of consensus, it seems to me that there are a lot of competitors on the outside who are very concerned about that issue of cross-subsidies that go from the monopoly rate base to the competitive entries in the parent company.

Presumably they would be interested in having legislation that would address this issue, is that not correct?

Mr. **York**. I would assume so.

Mr. **Wirth**. There are millions and millions of households that would also be concerned about legislation. So looking at the panoply of interests, everybody is in agreement for the most part in having legislation. I'm talking about the operating companies, the competitors, the public utilities commissions, and the consumers in this country who would not be interested in having——

Mr. **York**. I missed A.T. & T. in your list.

Mr. **Wirth**. Why would they not be interested?

Mr. **York**. They would not have signed the settlement agreement had they not felt that it was in their best interest compared with the alternatives. You referred earlier this morning to some of the interests having gone away in regard to your legislation.

I guess I jumped to the conclusion that some of that interest was on the part of A.T. & T. that dissolved.

Mr. **Wirth**. Would there be anybody else who would be opposed to this?

Mr. York. A suggestion is Department of Justice. I do not know what position they would take in regard to it, so long as the legislation did not infringe on the antitrust questions about which they are concerned. They are quite clear in that in a couple of things I have heard them say; they do not want legislation that recreates an antitrust problem.

Mr. Wirth. Let me close by saying that on the other side there are two points. First, Mr. Brown said in testimony before the committee that he felt legislation was needed. He was not pinned down as to what that legislation should be but yes, legislation was needed.

Second, I do not think we ought to forget the very long tradition within the Bell System of extraordinarily good service to everybody in this country at a price they could afford. There is that wonderful tradition there.

Now, what I am trying to get at, Mr. York, is one of the things one tries to do in the political process is to develop a consensus. I still tend to believe that A.T. & T., given its fine tradition and given the very creative leadership exercised by Mr. Brown in this extraordinarily difficult time, that we still have the possibility of arriving at that sort of consensus. I hope to move a piece of legislation which reflects the interests and concerns that has been expressed here and which is worthy of that very fine tradition of service we have come to expect from the Bell System.

That is certainly my fervent hope and I am very pleased to work with all of you.

Are there any words you would like to offer?

Mr. Rollins. Just one last comment, with regard to the evaluation issue. Let me urge as you begin to look at valuations to remember that what has been proposed in the consent decree is that it would make transfers at book prices. Ask yourself whether you would rather have the $600,000 investment, which Mr. Cresse described this morning, or the ongoing income stream of $20 million a year.

Mr. Wirth. That would be the difference between——

Mr. Rollins. In the market value of that ongoing stream. Ask yourself if you would rather have the book value of the intrastate toll equipment, which must be transferred under the consent decree from the State organization, that is from the local operating companies to the long lines division, and would you rather have the book value of that equipment or would you rather have the ongoing income stream which has been associated with the intrastate toll services.

Those are the kind of issues we think must be addressed.

Ms. Miller. I think one additional point on your point of consensus. I am very concerned and I think State regulators generally are very concerned, that in the pursuit of the new telecommunications goals, all of which are very worthy and which include variety and diversity and technological progress, in the pursuit of these very worthy goals we are going to lose sight of the very old-fashioned goal of universality which is a function, it would seem to us, of affordability, and I think that there may be conflicts here.

I certainly applaud any efforts to reach consensus but I think that at bottom, if it looks as though universality is going to be sacrificed, that we step back and take another look. Because I think this is something that we should not ignore, just because we have achieved it.

Mr. WIRTH. As you know, universality and affordability are key themes up front in the mission, and purpose of H.R. 5158 and all of the way through the legislation.

Ms. MILLER. I very much appreciate that.

Mr. WIRTH. I believe very strongly that we must look after the 230 million Americans using the basic communication system. As some of you have pointed out, you cannot survive in the modern day and age without access to the ability to communicate, whether it is accross the street, with your mother-in-law in Rhode Island, or all of the way across an 18,000 mile square district.

Ms. MILLER. We are very cognizant and appreciative of the fact that H.R. 5158 at bottom is evidence of concern for that goal.

Mr. SCHEUER. One final addition to the comment of my colleague from Texas, we have been talking a lot in terms of when the evaluation of the assets occurs, what assets get transferred and what method of valuation is utilized.

I do not think we should lose sight of exactly what the compensation will be in determining that. I hope we are not all sitting here thinking A.T. & T. is all of a sudden going to give *x* number of dollars of cash, however many those dollars may be. I do not think that is a certainty. I do not think anywhere it is written that that is what is going to happen and on a particular day *x* number of dollars of cash go to local companies that State commissions can recognize.

I think we should not lose sight of that. What is that form of compensation? It should be a form of compensation which State commissions can in fact recognize on behalf of the ratepayers.

Mr. YORK. An observation in regard to consensus. I would be delighted to be proved wrong. I would invite A.T. & T. to prove me wrong by the way they work with you and your subcommittee in the next few weeks. I think that would be marvelous and move the whole process and the whole telecommunications industry forward.

Mr. WIRTH. Thank you all for being with us and your contribution. We look foward to working with you and greatly appreciate your help.

[Whereupon, at 1:45 p.m., the hearing was adjourned.]

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PROPOSED SETTLEMENT OF UNITED STATES VERSUS A.T. & T.

TUESDAY, FEBRUARY 9, 1982

House of Representatives,
Subcommittee on Telecommunications,
Consumer Protection, and Finance,
Committee on Energy and Commerce,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1 p.m., in room 2212, Rayburn House Office Building, Hon. Timothy Wirth (chairman) presiding.

Mr. Wirth. The subcommittee will now come to order, our apologies for not having much room. Everybody can look out for a few empty seats which are sprinkled here.

This afternoon, the Subcommittee on Telecommunications, Consumer Protection, and Finance continues its examination of the settlement of the Justice Department's antitrust case against A.T. & T., and the proposed modification of the 1956 consent decree.

Last month, the subcommittee heard testimony on the settlement from A.T. & T. chairman Charles Brown and assistant attorney general William Baxter, representing the parties to the case.

While these witnesses answered many questions about the settlement, their testimony left many issues unresolved.

Some of these issues—such as the treatment of Yellow Pages, the valuation of assets, and the establishment of access charges—bear directly on the cost of local telephone service. Other issues, particularly the restrictions that the settlement places on the BOC's, could affect the quality of service available in the local exchange. A third category of unresolved issues relates to the treatment of A.T. & T.'s interexchange service, which together with interexchange service provided by Bell's noncompeting partners accounted for 96 percent of all toll revenues in 1980.

Today's witnesses were not directly involved in the antitrust case, or in the formulation of the proposed settlement currently before Judge Greene. Yet all of them—workers, customers, business and Government users, and competitors—will be directly affected by the eventual outcome of *United States* v. *A.T. & T.*

As we draft legislation to revise and update the Communications Act, we need to hear their views on the dramatic restructuring of the Bell System contemplated in the settlement. And we need to assure financial viability for the divested BOC's, for high-quality local service is essential to a well-functioning national telecommunications system. The themes presented here today will doubtless be explored in greater detail during the hearings we have scheduled over the next several weeks.

Before moving on, do any of my colleagues have comments to make? All right.

Our first panel is on the financial impact of the settlement. We have three distinguished witnesses from Wall Street with us who will be followed by representatives from the Communications Workers of America and IBEW.

Today we have with us from my left to right, everybody else's right to left, Mr. Tom Fendrich, vice president and general manager, Corporate Finance Department of Standard & Poor's; Mr. Robert F. Barrett, vice president of the American Municipal Bond Assurance Corp., New York; and Mr. Robert Burke, senior vice president and director of Moody's Investors Service.

Mr. **Burke**. Thank you, Mr. Chairman.

Mr. **Wirth**. I think you know the rules of the subcommittee. We would appreciate it if you could summarize your testimony within a 5-minute period of time, comment on what each other has to say, and then we can come back and get into questions and answers.

STATEMENTS OF THOMAS G. FENDRICH, VICE PRESIDENT AND GENERAL MANAGER, CORPORATE FINANCE DEPARTMENT, STANDARD & POOR'S CORP.; ROBERT F. BARRETT, VICE PRESIDENT, AMERICAN MUNICIPAL BOND ASSURANCE CORP.; AND ROBERT W. BURKE, SENIOR VICE PRESIDENT AND DIRECTOR PUBLIC UTILITY RESEARCH DEPARTMENT, MOODY'S INVESTORS SERVICE

Mr. **Fendrich**. Thank you, Congressman Wirth. It is a pleasure to be here today. Just an introductory comment from where Standard & Poor's is coming from, we are an independent public rating agency. We have been assigning bond ratings for 60 years and presently rate the securities over 4,000 corporations, municipalities and international organizations with a staff of 135 professionals. We rate securities of the Bell System, 40 independent telephone companies and competitors such as MCI, Southern Pacific, I.T. & T. and IBM and prospective competitors, as well.

A bond rating is a subjective judgment which addresses the safety of a debt issue, nothing more and nothing less. It is not an investment recommendation nor does it purport to be an audit. So-called investment-grade ratings are assigned to bonds likely to pay and are BBB and higher. A bonds are sound quality, AA are high quality and AAA are highest quality. The bonds of A.T. & T. and its wholly-owned subsidiaries are rated AAA except for New England Telephone at AA-plus and Pacific Telephone at A minus. These ratings are based on each company's fundamental and financial strength as well as the benefits of the holding company umbrella which has consistently helped support credit quality of the operating companies when they went through stressful periods.

On January 12, Standard & Poor's placed the ratings of these companies on creditwatch, our list of ratings monitored for potential rating changes, reflecting the future uncertainties relating to the prospective A.T. & T. divestiture.

Our rating concerns relate to credit protection following divestiture since a number of the Bell operating companies may be less able or less willing to maintain their very high credit quality levels over the long run. This does not mean that their ability to pay interest and principal is likely to be threatened for the foreseeable future. On the contrary, all or most all will maintain high creditworthiness, particularly considering A.T. & T.'s stated commitment that it will divest the companies in sound financial condition.

The bond community's concerns really are of a relative nature. They reflect the sudden change in view of a large amount of bonds outstanding, about $40 billion, all of which had previously been benefiting from the Bell System umbrella. And they reflect some uncertainty as to how precisely to evaluate credit quality after a divestiture.

These concerns are important to the bond market because the market prefers visibility, abhors uncertainty and because credit evaluation is an important factor in bond pricing decisions.

As explained in our detailed analysis of the divestiture's impact, there are both positive and negative implications for the operating companies, there is flexibility and commitment by A.T. & T. to strengthen operating company credit quality, and there are also uncertainties, some of which may remain for some time.

The net effects will be reviewed by Standard & Poor's following finalization of the divestiture plan. Our current analysis suggests that, at worst, several of the ratings may be reduced modestly.

The positive implications for the operating companies result from the clear definition and separation of a regulated environment from nonregulated businesses, thus substantially reducing their business risk. This regulated business protection, combined with declining labor and capital intensity should lend credit strength. In addition, the operating companies, as the primary local distributors of information, could benefit from the growth in enhanced information services and advancements in technology which would ameliorate cost pressures.

The negative implications reflect the removal of the Bell System umbrella and the longstanding A.T. & T. management commitment to maintain AAA ratings in the public interest. The former can be somewhat offset by formation of regional or national holding companies, which A.T. & T. has the flexibility to propose.

The uncertainties relate to the complex transactions and there are a number, and relate to the exact arrangements and how onerous they would be to any party including A.T. & T.

For example, A.T. & T.'s debt rating is on credit watch because A.T. & T. may be required by policymakers and regulators to go to unusual lengths to maintain operating company credit.

In addition, there is concern that some regulators may believe for whatever reason, that the divestiture plan was not accomplished in their best interest and would reflect this belief in their treatment of individual operating companies. Based on past regulatory decisions, Pacific Telephone is a company that could be so affected.

Mr. WIRTH. Do you want to complete that?

Mr. FENDRICH. Thank you.

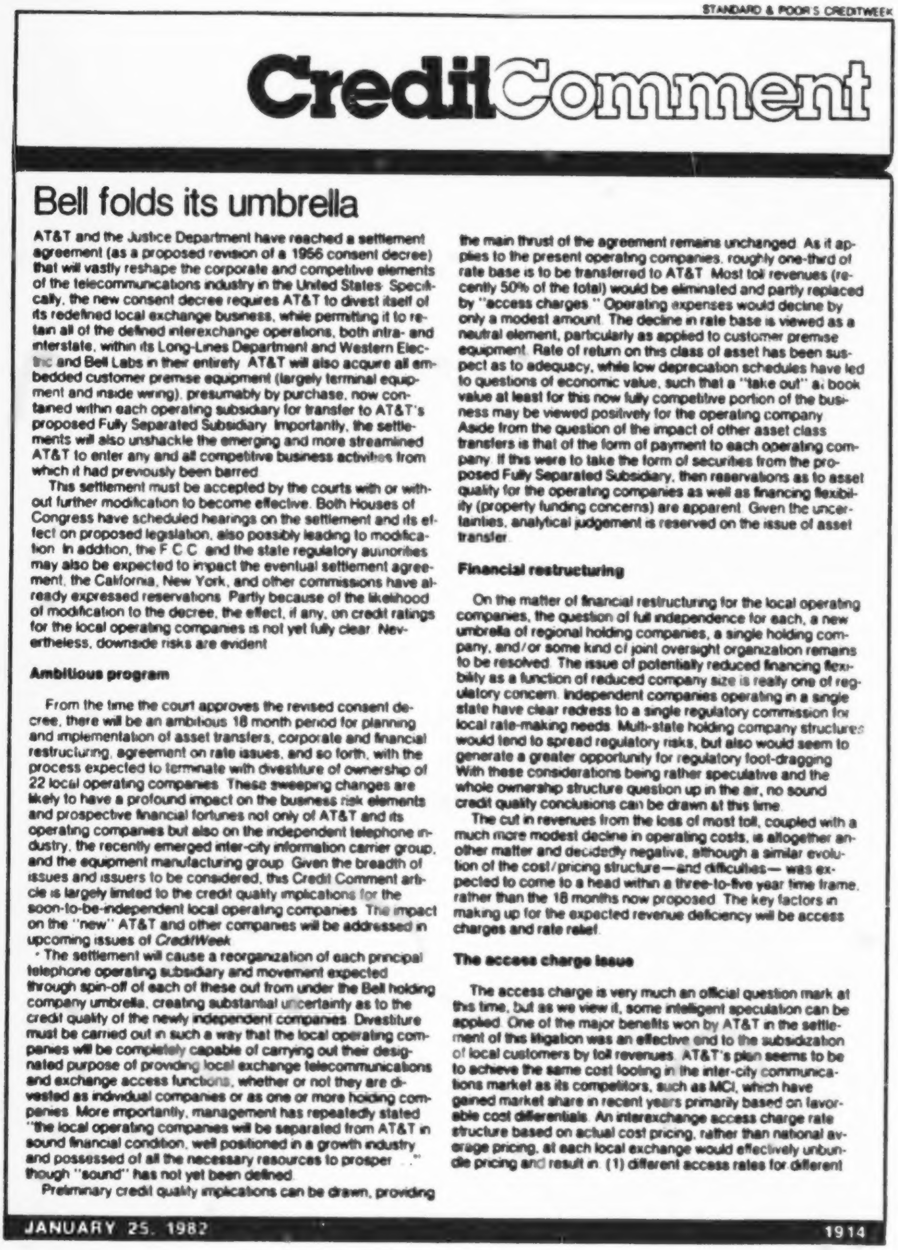
Is the divestiture likely to result in higher rates for consumers? Not anymore than would otherwise be the case, given the new competitive realities of the telephone business. That is as best as we can see this situation now. In any case, Federal and State regulators would have control over the issue to some extent, reflecting public policy on how to implement access charges.

Is Federal legislation required at this point to override the provisions of the proposed divestiture? Standard & Poor's does not, as a matter of course, make recommendations on public policy matters. From an analytical standpoint, it appears that the specific elements of the forthcoming divestiture plan will be most important to credit quality and that there will be sufficient time to review such elements prior to considering the desirability of Federal legislation.

We do not ignore the fact that A.T. & T. is committed to high credit quality, and has been for many decades, and has for many years provided the best telphone service in the world while balancing customer, employee, stockholder, and bondholder interests.

Thank you.

[Attachment to Mr. Fendrich's prepared statement follows:]



CreditComment

Bell folds its umbrella

AT&T and the Justice Department have reached a settlement agreement (as a proposed revision of a 1956 consent decree) that will vastly reshape the corporate and competitive elements of the telecommunications industry in the United States. Specifically, the new consent decree requires AT&T to divest itself of its redefined local exchange business, while permitting it to retain all of the defined interexchange operations, both intra- and interstate, within its Long-Lines Department and Western Electric and Bell Labs in their entirety. AT&T will also acquire all embedded customer premise equipment (largely terminal equipment and inside wiring), presumably by purchase, now contained within each operating subsidiary for transfer to AT&T's proposed Fully Separated Subsidiary. Importantly, the settlements will also unshackle the emerging and more streamlined AT&T to enter any and all competitive business activities from which it had previously been barred.

This settlement must be accepted by the courts with or without further modification to become effective. Both Houses of Congress have scheduled hearings on the settlement and its effect on proposed legislation, also possibly leading to modification. In addition, the F.C.C. and the state regulatory authorities may also be expected to impact the eventual settlement agreement; the California, New York, and other commissions have already expressed reservations. Partly because of the likelihood of modification to the decree, the effect, if any, on credit ratings for the local operating companies is not yet fully clear. Nevertheless, downside risks are evident.

Ambitious program

From the time the court approves the revised consent decree, there will be an ambitious 18 month period for planning and implementation of asset transfers, corporate and financial restructuring, agreement on rate issues, and so forth, with the process expected to terminate with divestiture of ownership of 22 local operating companies. These sweeping changes are likely to have a profound impact on the business risk elements and prospective financial fortunes not only of AT&T and its operating companies but also on the independent telephone industry, the recently emerged inter-city information carrier group, and the equipment manufacturing group. Given the breadth of issues and issuers to be considered, this Credit Comment article is largely limited to the credit quality implications for the soon-to-be-independent local operating companies. The impact on the "new" AT&T and other companies will be addressed in upcoming issues of *CreditWeek*.

The settlement will cause a reorganization of each principal telephone operating subsidiary and movement expected through spin-off of each of these out from under the Bell holding company umbrella, creating substantial uncertainty as to the credit quality of the newly independent companies. Divestiture must be carried out in such a way that the local operating companies will be completely capable of carrying out their designated purpose of providing local exchange telecommunications and exchange access functions, whether or not they are divested as individual companies or as one or more holding companies. More importantly, management has repeatedly stated "the local operating companies will be separated from AT&T in sound financial condition, well positioned in a growth industry and possessed of all the necessary resources to prosper . . ." though "sound" has not yet been defined.

Preliminary credit quality implications can be drawn, providing the main thrust of the agreement remains unchanged. As it applies to the present operating companies, roughly one-third of rate base is to be transferred to AT&T. Most toll revenues (recently 50% of the total) would be eliminated and partly replaced by "access charges." Operating expenses would decline by only a modest amount. The decline in rate base is viewed as a neutral element, particularly as applied to customer premise equipment. Rate of return on this class of asset has been suspect as to adequacy, while low depreciation schedules have led to questions of economic value, such that a "take out" at book value at least for this now fully competitive portion of the business may be viewed positively for the operating company. Aside from the question of the impact of other asset class transfers is that of the form of payment to each operating company. If this were to take the form of securities from the proposed Fully Separated Subsidiary, then reservations as to asset quality for the operating companies as well as financing flexibility (property funding concerns) are apparent. Given the uncertainties, analytical judgement is reserved on the issue of asset transfer.

Financial restructuring

On the matter of financial restructuring for the local operating companies, the question of full independence for each, a new umbrella of regional holding companies, a single holding company, and/or some kind of joint oversight organization remains to be resolved. The issue of potentially reduced financing flexibility as a function of reduced company size is really one of regulatory concern. Independent companies operating in a single state have clear redress to a single regulatory commission for local rate-making needs. Multi-state holding company structures would tend to spread regulatory risks, but also would seem to generate a greater opportunity for regulatory foot-dragging. With these considerations being rather speculative and the whole ownership structure question up in the air, no sound credit quality conclusions can be drawn at this time.

The cut in revenues from the loss of most toll, coupled with a much more modest decline in operating costs, is altogether another matter and decidedly negative, although a similar evolution of the cost/pricing structure—and difficulties— was expected to come to a head within a three-to-five year time frame, rather than the 18 months now proposed. The key factors in making up for the expected revenue deficiency will be access charges and rate relief.

The access charge issue

The access charge is very much an official question mark at this time, but as we view it, some intelligent speculation can be applied. One of the major benefits won by AT&T in the settlement of this litigation was an effective end to the subsidization of local customers by toll revenues. AT&T's plan seems to be to achieve the same cost footing in the inter-city communications market as its competitors, such as MCI, which have gained market share in recent years primarily based on favorable cost differentials. An interexchange access charge rate structure based on actual cost pricing, rather than national average pricing, at each local exchange would effectively unbundle pricing and result in: (1) different access rates for different exchanges and (2) put all inter-city carriers on the same basis for this portion of their costs, a prospect which a more streamlined and competitive AT&T should relish, especially if it is able to de-average its toll rates.

The level of interexchange access charged by each local operating company will, in our judgement, likely be a function of volume, investment in related facilities, and operating costs, with considerable emphasis placed on volume. In fact, the "subsidization" of local rates will very likely continue through the application of these access charge revenues. However, in no cases do we assess that this new source of revenues will fully offset the loss of present toll revenue separations, given that existing AT&T interstate services are substantially overpriced.

Regulatory concerns

For the local operating companies, the question of sizing the potential revenue stream from interexchange access charges is really one of relative pain in terms of how much additional rate relief will be needed from local rate payers to fully offset the toll revenue loss. This issue, among a number of others, including pricing of assets, local measured service, and jurisdictional questions, has not gone unnoticed by state regulators, who have been quite vocal in stating their concerns in the few days since the AT&T/Justice Department agreement was announced. The issue of interexchange access charge (which we believe will be conducted on a "one-way bill-and-keep" basis rather than "end-to-end" sharing or the present pool settlement arrangement) will probably be a significant bone of contention, since it would appear to strongly favor operating companies with high density toll traffic volumes.

Accordingly, jurisdictions having low density traffic patterns would have to make up the difference through very substantial local rate increases at a time when state regulatory bodies are beset with other rate increase pressures resulting from the Economic Recovery Tax Act of 1981 and generally higher operating and capital costs. Based on our preliminary analysis which measured the interplay of net plant investment, toll calling volumes, and lines in service, it appears that C&P of both Maryland and Washington, New York Bell, Diamond States, and Illinois Bell may be more vulnerable than other local operating companies in terms of ability to generate strong access charge revenue and have a corresponding greater need to seek jurisdictional rate relief through their respective state commissions.

Companies that are relatively favorably postured on this score would appear to include New Jersey Bell, Pacific Telephone, Pacific North West Bell, Southern Bell, and Southwestern Bell. However, this preliminary analysis does not address the matter of proposed asset transfers to AT&T, which will likely affect each operating company net plant account somewhat differently. Nonetheless, the prospect for layering in additional rate increase needs cannot be expected to be well received in the state regulatory arenas. Thus, there is the clear potential for regulatory foot-dragging and weakened earnings and cash flow measures as the revenue requirements issue is thrashed out.

Operating company implications

For the local operating companies, the questions raised regarding asset quality, revenue and regulatory uncertainty, and potential for financial deterioration are sufficient to create credit anxiety. But there are some favorable aspects to be addressed. Before the settlement agreement, the operating companies were on a fast track toward becoming multi-purpose corporations with most business segments experiencing rising competitive risks. Subsequent to the settlement agreement becoming effective, the typical operating company will revert to a truly monopolistic entity, acting as the exclusive local communications system within a franchised area. Its services will be essential to all interexchange carriers (like AT&T) and local users. As long as technology calls for the local network to remain largely wired, the operating company will be virtually the sole provider of local service.

While minor competition in the form of microwave and coaxial cable does exist presently, there are substantial physical and cost limitations on meaningful market penetration for these entries. Very major and cost effective technological breakthroughs in such areas as fiber optics and cellular radio would be required to upset the fundamental business position of the local operating companies. Thus, pure business risk for the operating company has been curtailed to a point that the risk elements appear to be very similar to those of a major electric distribution utility having no long-term power supply worries.

Moreover, the operating companies' capital spending requirements in the period ahead would appear to be somewhat reduced and the new investment recouped more rapidly under the FCC's capital recovery items and the 1981 Tax Act. Depending on the degree of need to modernize the local network and add to outside plant to meet the demand for new services, we project the growth in rate base to be much slower than in the past and, in some cases, rate base may stagnate or even decline. While the emerged operating company is likely to be more labor intensive than in the past, the continued application of operating efficiencies, coupled with an extension of historic growth in call volumes, would serve to be at least partly offsetting, ameliorating the need for local rate increases once the reorganization revenue requirement issues are sorted out.

Liberal debt leverage

As such, the new lower-risk operating company would appear to be positioned to carry a more liberal level of debt leverage and to provide less in the way of fixed charge coverage protection for debtholders than before, without necessarily impairing the 'AAA' credit quality currently assigned to most Bell system companies. The caveat here, of course, is that the regulatory response, particularly at the state level, contains the risks in the revenue stream and is strong enough to fully reflect the costs of *all* components of the capital structure. This will likely present a substantial challenge in nearby years. Management and its commitment to maintenance of credit quality will become far more important as the Bell System imprint on management and its commitment to credit quality fade in the long term—which is what bond ratings are all about. Given the right regulatory, financial, and management ingredients, the new local operating companies can retain the senior debt ratings held at present and at the time of divestiture.

Although it is too soon to fully evaluate the effect of this divestiture on AT&T's operating companies, we can still appraise creditworthiness in present terms and point out the relative strengths and weaknesses as well as any compensating or mitigating factors. In S&P bond rating seminars and on other occasions, we have indicated some numerical financial criteria benchmarks for 'AAA' rated telephone operating companies. Certain of these are:

Consistent Pretax Fixed Charge Coverage	*4.5 times or better*
Total Debt as a % Total Capitalization	*40% maximum*
Total Equity as a % Total Capitalization	*60% minimum*

In addition, we have also indicated that operating company capital spending at a level of about 15% of permanent capitalization represents average stress and that the company should be able to generate 80–85% or more of this spending each year internally. At the same time, capital spending at or above 20% of capitalization represents unusual stress and, since cash flow seldom grows as rapidly as spending, internal generation in the range of 65–80% is acceptable, though not desirable from a viewpoint of financial stress.

Statistical indicators

Statistics for the principal operating subsidiaries scheduled to be divested for the twelve months ended September 30, 1981 are carried in the accompanying table. Bell Telephone Co. of Nevada is not listed, as it consolidated with Pacific Telephone Co. and Telegraph Co.

From a coverage perspective, Bell of Pennsylvania, C&P of Maryland, C&P of West Virginia, Michigan Bell, Mountain States, and Pacific Northwest Bell are substantially below our 4.5x tar-

(continued on next page)

get. In compensation, C&P of West Virginia demonstrates an equity level among the highest of any of the listed companies. Mitigating the situation for two of the others, Mountain States and Pacific Northwest, is the fact that they were both majority-owned subsidiaries until the beginning of 1981. Both have since demonstrated improvement in coverage and capital structure. The other three have held about even or improved somewhat as in the case of Michigan Bell. Here, the Michigan Commission has constructued a consumer price index rate adjustment plan for Michigan Bell that allows prompt offsets each year to general cost increases. Over the past three years, all Bell companies have suffered from the errosive effects of inflation and higher interest rates as well as delays in obtaining offsetting revenues.

Capital structure

Capital structure has traditionally been a key element of support for the ratings on the principal operating companies. The arithmetic average for the common equity level in the principal operating companies (excluding P.T.&T.) is 58.6% which, although not at the benchmark level, is, nevertheless, comfortably close, with a number of companies at or over that level. The more weakly structured former majority-owned companies are now showing significant improvement in their capital structures. Those companies with lower common equity levels, notably Michigan Bell, New York Telephone, Wisconsin Bell and the former majority owned companies, appear vulnerable from a rating perspective, unless there is a substantial decline in financial risk in the corresponding future local operating company, or there is significant improvement in capitalization by the time of divestiture.

Construction expenditure levels continue to be higher in terms of capitalization, particularly in a broad band from the Mason-Dixon Line in the East, down through the South and West to and up the Pacific coast. Ratio of expenditures to capitalization are close to or above the 20% level with a high of over 20% in the largest company, Pacific Telephone. Levels of internal generation are weak and generally below expectations for 'AAA' rated operating companies. However, there should be some significant improvement in the area of internal generation as the Tax Act of 1981 takes hold in 1982. AT&T has already indicated that on a system-wide basis, internal funding should increase to about 74–76% in 1982 from about 63% in 1981.

Pacific Telephone & Telegraph Co. at 'A–' remains the weakest of the operating companies from a financial perspective with weak ratio levels even for its current rating. On August 29, 1981 (*Fixed Income Investor, page 709*), present ratings were affirmed based on the expected effects of a $610 million revenue increase and the positive regulatory principles and attitudes indicated in the rate order, in particular, a 17.4% return on common equity allowed and a stated desire that PT&T should have a 50–50 debt/equity capital structure within two years. While the PT&T credit situation remains fluid, the planned divestiture of this company could help rid the California regulatory atmosphere of serious questions regarding PT&T's financial dealings with AT&T.

In summary, while some of the principal operating companies may be termed weak, compensating factors, such as current capital structure and cash flow, as well as the absence of clearly defined prospective structures, earning capabilities and spending needs, warrant no rating action at this time. We will be closely monitoring the companies, regulatory and legislative responses, and time schedules for divestitures.

John Hardy
Dennis Dolan

Bell System statistics, twelve months ended September 30, 1981

(Mil. $)	Net cash Flow	Cash construction	% Cash flow/const. exp.	% Const. exp./total capitalization	Pretax coverages (x)	Return on equity (%)	Total cap.	Percent			
								STD	LTD	PFD	CME
Bell of Pennsylvania	$ 437.2	$ 614.3	71.2	15.7	3.94	11.1	3907.9	1.4	40.8	—	57.8
Ches & Pot Md	197.9	315.2	62.8	16.8	3.27	9.4	1870.6	4.0	36.7	—	59.3
Ches & Pot Va	240.5	357.5	67.3	17.3	4.29	11.8	2064.7	5.6	34.1	—	60.3
Ches & Pot Wash D.C.	76.7	110.4	69.5	17.2	3.87	9.8	643.0	2.2	35.4	—	62.4
Ches & Pot W. Va	83.7	146.3	57.2	20.3	3.17	10.3	720.4	9.6	29.6	—	60.8
Diamond State	32.8	45.4	72.2	15.5	4.63	12.1	293.8	10.9	31.0	—	58.1
Illinois Bell	507.2	621.2	81.6	14.7	4.12	11.7	4218.0	2.3	38.8	—	58.9
Indiana Bell	183.5	204.1	89.9	14.4	5.39	13.9	1414.0	0.2	38.4	—	61.5
Michigan Bell	392.0	517.6	75.7	15.1	3.47	9.9	3427.1	0.4	40.8	—	58.8
Mountain States	746.7	1178.5	63.4	21.4	3.74	11.6	5515.3	5.5	37.7	—	56.8
New Jersey Bell	398.7	630.0	63.3	17.9	4.38	11.9	3511.0	4.0	35.3	—	60.7
New York Telephone	1043.5	1335.8	78.1	14.3	4.36	11.4	9351.2	6.3	38.2	—	55.5
Northwestern Bell	429.8	550.6	78.1	15.5	4.33	11.7	3543.6	3.6	35.5	—	60.9
Ohio Bell	315.5	431.4	73.1	16.2	3.95	11.7	2665.4	7.4	34.0	—	58.6
Pacific Northwest Bell	331.3	541.1	61.2	19.0	3.92	11.8	2853.2	6.9	37.8	—	55.3
South Central Bell	923.1	1275.1	72.4	17.6	4.51	12.5	7247.8	3.5	36.0	—	60.5
Southern Bell	1078.5	1762.1	61.2	19.8	3.97	11.5	8907.3	6.2	35.4	—	58.4
Southwestern Bell	1355.8	2101.8	64.5	17.3	4.11	11.3	12178.4	4.5	39.2	—	56.3
Wisconsin Bell	167.2	195.3	85.6	14.6	4.19	12.0	1332.0	5.6	38.0	—	56.3
New England Telephone (AA+)	529.0	689.5	76.7	16.8	3.98	12.2	4097.0	2.0	42.8	—	55.2
†Pac. Tel & Telephone (A–)	1182.9	2647.8	44.7	21.8	1.77	7.4	12171.7	5.3	51.6	5.2	37.8
Total	10853.5	16271.1					81933.4				
Principal Bell Companies											
Arithmetic Average	—	—	70.0	17.1	3.97	11.29	—	4.6	37.5	—	57.6
Weighted Average	—	—	65.5	17.7	3.59	11.17	—	4.6	38.5	—	56.2
Without Pacific Tel & Tel											
Arithmetic Average	—	—	71.2	16.8	4.08	11.48	—	4.6	36.8	—	58.6
Weighted Average	—	—	69.5	17.1	4.10	11.55	—	4.4	37.6	—	57.9

†Pacific Tel 90% owned

Karen E. Miller

Mr. WIRTH. Thank you very much, Mr. Fendrich.
Mr. Barrett.

STATEMENT OF ROBERT F. BARRETT

Mr. BARRETT. Thank you, Congressman Wirth.

I appreciate the opportunity to present our views at this time. I had been associated with various Wall Street firms heading up bond departments over the past few years. I appreciate the opportunity to express the views of not just Wall Street, but of what the accounts themselves, the purchasers of the telephone bonds, have been thinking since January 8.

Prior to this announcement the telephone system bonds, the operating company bonds, had been almost considered the bellwether of corporate bonds. But when the Government started to increase the amount of debt outstanding, the Government market itself became the bellwether of all trading.

But, all corporate debt traded off of the Bell System bonds, since that market was characterized by tremendous liquidity and depth. You could also buy and sell any particular issue you wanted. It enabled most pension funds to manage their portfolios according to their fiduciary responsibilities as they saw them.

However, since this announcement, the market for the telephone bonds has gone into almost complete disarray. The market dropped roughly a little over 2 percentage points after. Then it came back, but on very, very little trading.

What you are finding right now in the marketplace is that the activity in trading is probably less than half of what it had been prior to the announcement. The number of accounts trading bonds, willing to trade bonds, has dropped very, very dramatically.

You used to be able to sell $5 million, $10 million, $20 million bonds par value and you just can't do that. There is no market for the bonds. What we are also finding in the marketplace is that there are some trades being done now where the telephone bonds are being traded at a level equivalent to medium to high quality electric utility bonds—AA electric utilities—and even in some cases your A electric bonds are trading at the same yield level of some of the telephone subsidiary paper. This has caused a tremendous amount of concern in the marketplace.

One other factor you are finding in the marketplace is that the marketplace is beginning to differentiate very clearly among the Bell operating company credits. By that, I mean prior to the announcement between the best and the worst operating sub, excluding PACTEL which is a very unique situation, there was only 5 basis points difference, 0.05 percent.

Right now, you are finding the spread to be roughly probably 30 basis points, 0.3 percentage point, which is a very sharp delineation in that marketplace. That allows a lot of trades to be done of trading even yield, as it were, between electrics and the Bell System paper.

In summary, you are finding tremendous volatility in the marketplace, and you are finding the trading activity to be off over 50 percent. There has been a dramatic decrease in the number of institutions trading these bonds. One of the reasons you find this is that a lot of bond buyers are saying, How can I possibly buy a new bond from a Bell sub, not knowing what the risks are 5 years from now? How could a prospectus be written? What is the company to be like? So they feel that they would probably not be able to buy these bonds under their fiduciary responsibilities.

The other thing you find given the opening up of the spread of these bonds is that most investors with strong analytical capabilities do not expect this group to remain AAA quality over the years. Very few sophisticated, or people with good research staffs even today call this a AAA quality group. I think you will also find they feel the damage has been done, the announcement on January 8 has created a negative impact. They really feel very disappointed in this whole process. They have lost a tremendous amount of market value in the bonds. You will find a lot of the statements by the parent are not making much of a positive impact in the marketplace; that is, "We will set up the companies so that they will be AAA quality when it starts."

Investors are not worried about that. They are worried about what the company will look like after. I think their fears are very justified. Thank you.

[Mr. Barrett's prepared statement follows:]

STATEMENT OF ROBERT F. BARRETT

THE PROPOSED AT&T/JUSTICE DEPARTMENT ANTITRUST SETTLEMENT

A View From Wall Street

I. Telephone Bond Trading Prior to the Settlement

Until five or six years ago Bell System debt was the ultimate benchmark of quality of the corporate bond market. Naturally, these securities were sold at an interest preferentially low and only slightly higher than U.S. Treasuries. The significant increase of U.S. Government obligations, i.e., long Treasury offerings, have replaced Bell System bonds as bellweather trading issues. As a result, Bell bonds are priced cheap relative to long Treasury issues. This shift in focal point has not diminished the marketability of new issues and, in fact, Bell subsidiary company debt has remained the most actively traded debt in the entire corporate bond market. The generally high quality of the debt combined with the breadth of institutions holding it, along with frequent new issues, have made the Bell subsidiary company debt market more liquid (more large issues outstanding) and deep (more investors holding these issues) than any other segment of the corporate bond market.

During the last two years there have been changes in the Bell subsidiary company debt market. Inflation worries combined with an inverted yield curve have made the System's typical 40-year debentures less appealing to investors. As a result, short-term debt and intermediate term bonds have been issued more frequently and traded more actively in the market. These intermediate bonds traded slightly more actively than the more traditional Bell Telephone subsidiary long-term bonds, primarily because the amount of the subsidiary long bonds outstanding is so huge that their market has more liquidity and depth.

As interest rates have risen, the yields on long Telephone bonds have gradually widened against long Treasuries from 190 basis points to about 240 basis points (100 basis points is equivalent to 1%) immediately prior to the settlement announcement. This means if a long Treasury bond yielded 14%, a comparable maturity Bell bond yielded 16.4%.

II. The Market Following the Announcement

On January 11, 1982, the Monday following the divestiture announcement, the bond market declined on light trading but long Telephone bonds dropped about 30 basis points more than the market in general; hence, the spread between Bell Telephone operating company and long Treasury bonds stood at 270 basis points. By Wednesday, however, yields on long Telephone bonds had improved, and the average yield spread between Telephones and comparable Treasury issues narrowed to about 240 basis points. Trading was very light, however, and it was basically a bid market. Since then, the market has begun to differentiate among the quality of the Bell subsidiary companies, and the less well regarded ones have suffered a 25 basis point increase in yield.

Interestingly, the lower coupon Telephone bonds, in the 8% to 9 1/2% range, have not yet and probably will not recover in price. The yield spread between Bell Telephone operating companies and comparable Treasury issues had been between 75 basis points and 125 basis points. Trading in this sector has been especially light since many investors would have to book substantial losses if these bonds were sold.

In addition, it is estimated that 60% or more of secondary trading in current coupon issues is accomplished via trading activity against new Telephone bonds. Given the uncertainty in the marketplace, it would be difficult to sell new debt instruments to U.S. financial institutions. On the other hand, institutions have consistently told me they would only look at a new issue if the yield was in line with medium quality electric utility paper. While this may or may not be rational, we must be concerned about how these companies will finance external requirements over the next 18 months.

While Bell Telephone operating company trading activity remains very low, there is a perceived change in credit quality. Prior to the January 8th announcement, the yield differential among all the Bell Telephone operating companies had been 5 basis points, except for Pacific Telephone bonds. Currently, however, the marketplace has begun to sift the companies according to credit worthiness. There is a 25 basis point spread between the best perceived credits and the worst (excluding Pacific Telephone with its own special situation). This puts the yield on the less well regarded Bell Telephone operating companies directly in line with low to medium quality "AA" electric bonds.

In general this announcement has caused havoc in the telephone bond market:

A. The market has lost a significant portion of its liquidity and depth. There is over a 50% decrease in total trading activity.

B. Price volatility has increased sharply.

C. There has been a dramatic decrease in the number of institutions trading these bonds.

D. It is very difficult to find an investor with fiduciary responsibility who would buy a new issue long telephone bond. The question being asked is "How can I buy a long-term obligation of these companies if I have little or no idea of the associated risks 5 years from now?"

E. Investors with strong analytical capabilities do not expect this group to remain "AAA" quality.

F. The damage of January 8th has been done; no amount of rationalization on the part of interested parties will diminish the negative impact.

G. Statements by the parent are making little positive impact in the marketplace.

III. Are the Market Fears Rational?

Since January 8th, I have been trying to evaluate market reaction and determine its impact on the Bell Telephone operating companies' possible future cost of capital and ability to raise needed funds, as well as to determine its impact on the performance of pension funds and other institutional portfolios. Certainly one has to ask whether or not these dramatic pricing changes are permanent. I believe they are, and they have become even more sharply delineated.

While most institutional investors were aware of the coming diminution of interstate toll revenues, they believed the Bell umbrella would still be there providing financing support. I believe such investors were correct in being only mildly concerned with such revenue loss because of the perceived existence of the back-up umbrella. The Bell Telephone operating companies enjoyed tremendous financing flexibility via commercial paper, bank lines, and advances from their parent. Without the implicit backing of the parent and the absence of master notes and advances, then commercial paper and bank lines will be more expensive and difficult to obtain.

The settlement calls for both inter- and intra-state toll business to remain with the parent. This leaves the Bell Telephone operating companies with only local transmission revenues. Since toll revenues currently amount to an average of nearly 50% of total operating revenues for each subsidiary, these revenues will not be available for debt service. Unless Congress sees the light, and unless dramatic action is taken, telephone quality and service will deteriorate and the cost to the residential user will skyrocket.

Only partial relief may be available via access charges since economic and political reality cannot be completely disregarded. Therefore, it must be questioned if the deterioration of service can be reversed.

The loss of terminal equipment also hurts the Bell Telephone operating companies, especially those with large metropolitan centers. Terminal equipment for the System amounts to $12 to $15 billion while the revenues derived are at least that much with some experts putting the revenues as high as $19 billion. Assuredly, there are serious problems as to how this equipment will be priced, but with the user having choices concerning owning or leasing of equipment, most experts project a significant decline in revenues to the Bell Telephone operating companies. Importantly, these revenues provided substantial subsidies to the residential rate payer.

In effect, what we face is a 25% to 30% loss in assets with a potential decline in reveneus of somewhere between 40% and 50%.

Looking at this another way one can ask what will the Bell Telephone companies have left? The only business left for the Bell Telephone companies may be white pages which does not make any money and local exchange traffic which is the cost-increasing part of the business. Another problem is that even this local exchange business is not assured. More and more private companies are bypassing the local exchange and AT&T may even circumvent the local exchange via cables, etc., depending on the level of future local access charges. Large volume traffic may completely bypass the local exchange, leaving the Bell Telephone companies with less potentially profitable business and in the unenviable position of seeking disproportionately large local rate increases.

Other serious questions concerning the breakup remain. For example:

A. What might the balance sheets of the Bell Telephone companies look like?

B. Operating company outstanding debt is a direct obligation of the subsidiary. If assets are removed from the subsidiary, what will the asset protection of the debt be?

C. How will the Bell Telephone operating companies be financially compensated for the assets they have lost lost?

D. Will the parent assume some of the debt of the Bell Telephone operating companies?

E. If the parent assumes some debt of the Bell Telephone operating companies, will it be the high or low coupon issues, and how will this be determined?

F. Will the changover be made gradually, or on a flashcut basis?

Pressure on state commissions to grant local rate increases will be substantial. Prior to the settlement announcement there were estimates that local rates would have double, and in some cases, even triple. If access charges are volume-related, the companies with low density toll volume will be most negatively impacted. On the other hand, if there is a sharing of access charges or a modification of the present settlement arrangement, then the high density toll volume Bell Telephone operating company stands to be more vulnerable. In either case there will be a severe negative impact on the low toll usage customer whose monthly bill could increase two to three times. This is in contrast to a consumer whose monthly bill is mainly toll call related. In this latter case, which often is typical of the more affluent, the increase in the monthly bill will not be as substantial on either an absolute or relative basis.

If state regulatory bodies are unwilling or politically unable to grant sufficient rate increases until the revenue requirements of the Bell Telephone operating companies become clear, the companies will suffer financial deterioration to a point where the long-term financial viability of the local system is in serious question.

Mr. WIRTH. Thank you very much, Mr. Barrett.

Mr. Burke.

STATEMENT OF ROBERT W. BURKE

Mr. BURKE. Thank you.

Moody's Investors Service is known both as a publisher of financial information and as a rating agency. As senior vice president and director of Moody's Public Utility Research Department, I am joined by Jeffrey Evans to comment on the possible impact of a consent decree on the ratings of American Telephone & Telegraph telephone subsidiaries.

Rating is basically an analytical process, and aimed at measuring the degree of risk involved in the ability and willingness of the borrower to pay interest and principal in full, and on time.

For the purpose of expressing our opinion or judgment of investment risk or quality, we use a set of symbols, each symbol representing a group in which the quality characteristics are broadly the same.

We use nine symbols to cover the range in quality, proceeding from AAA to C. The A, AAA, to B, AA range takes in bonds of best quality on down to bonds of medium quality. The remaining five categories, BA to C, indicate increasing degrees of speculativeness on down to situations which are near or in default.

Local telephone companies, once split from American Telephone & Telegraph will be exposed to a new environment. Immediately following the January 8, 1982, consent decree, Moody's announced that the ratings on the affected companies would be maintained at their current level for the time being.

However, we cautioned that because the consent decree removes these companies from the umbrella of A.T. & T. and limits their service offerings, that the vagaries of State regulation will become increasingly significant in the rating of their securities, and that we did not expect the homogeneity of these ratings to remain intact as additional information comes to light.

All of the wholly owned telephone operating subsidiaries of A.T. & T. are accorded our highest ratings. The Pacific Telephone Co. has an A rating on its long-term bonds by Moody's. The ratings of the telephone operating companies reflect three basic characteristics: The operations of the operating company itself, the value derived from the operating company from its affiliation with the entire Bell System, and the value derived from the operating—by the operating company from its affiliation with the parent, American Telephone & Telegraph Co.

Our concerns can be grouped into three major categories: One, organization; two, business; and, three, regulation. Very briefly, the benefits of the whole of the organization to each local company has been access to human resources, technological, managerial and financial expertise, and the financing capability of the parent company.

Regarding the business condition, loss of the parent association creates uncertainties relative to interstate toll business, as would the loss of intrastate toll business. These adjustments may serve to accelerate the diminishing subsidy of local service by toll service.

Regulation on a State level would then grow in significance as these telephone companies would be very more dependent on adequate local rates to maintain their level of profitability.

In summary, the terms of the consent decree significantly changed the business structure of the Bell operating companies. The loss of the parent company umbrella, severe limitations on future business opportunities available to the companies, and greater reliance on increasing local service rates are of serious concern to us.

In addition, several aspects of the implementation of the consent decree create a significant degree of uncertainty as to the ability of the operating subsidiaries to maintain financial postures commensurate with their current ratings.

Specifically these uncertainties include, one, the valuation of the assets will be transferred. Two, the changes in capitalization associated with the asset transfer and three, the organizational structure of the divested companies. Thank you.

[Mr. Burke's prepared statement follows:]

STATEMENT OF ROBERT W. BURKE ON BEHALF OF MOODY'S INVESTORS SERVICE

I believe that the best contribution I can make today would be to share with this Committee Moody's thoughts and concerns, from its corner of the world, regarding the possible impact of the consent decree on the debt quality of present AT&T telephone subsidiaries.

First, and simply for background, a brief summary of Moody's bond rating system and its philosophical view of public utilities may be helpful.

The original purpose of Moody's ratings, first appearing shortly after the beginning of this century, and the purpose ever since, has been to provide the investor with a simple means of noting investment quality; that is, to provide an informed, unbiased opinion of the general investment quality of bonds. You all know what quality means. It is essentially how well interest payments and principal are protected. It is sometimes defined more technically as the degree of risk involved in the ability and willingness of the borrower to meet all the terms of the bond contract over its full life.

For the purpose of expressing our opinion or judgment of investment risk or quality, we use a set of symbols, each symbol representing a group in which the quality characteristics are broadly the same. We use nine symbols to cover the range in quality, proceeding from Aaa to C. The first four rating categories Aaa - Baa range from best quality down to medium quality. The remaining five categories, Ba - C, indicate increasing degrees of speculativeness on down to situations which are near or in default. I am sure you will recognize that, of necessity, there is a certain broadness in each rating category to accommodate the practical fact that, for example, some Aa bonds are somewhat better than other Aa bonds.

Utility companies, including those in the telephone business, are capital intensive. This means that in addition to raising equity capital, they must also borrow large amounts of money in order to properly serve their franchise. To borrow the money they need each year, these companies must present proper financial credentials. They must present their credibility to banks, insurance companies, pension funds and the American public in general.

There are no inordinate profits made by or through these companies. Management does not support million-dollar-a-year managers and speculators who seek the "big-killing" do not put their money into these companies. The ultimate objective of the utility company is to provide reliable service on demand. To do this it must, under our system of government and economics, provide incentive for investment. This incentive is not based on a "double-your-money-overnight" philosophy. Rather, it is based on a gradual growth incentive - one which provides a fair return over a period of time.

These companies must seek to borrow in an atmosphere of increasing risk which is not really of their own making. To assure the lender that his money is in reasonably safe deposit, the utility must provide additional equity investment through reasonable profits and sale of its common stock. Any sensible lender would require as much.

A dangerous phenomenon which may be arising is a regulatory timerity regarding basic economic risk-reward relationships. Risks have increased for public utility investors and, in response, there has been an attempt to increase equity investment - a fundamental reaction in a free-enterprise society. The lender says, "If I am to assume more risk, then I want more equity to support me." The equity investor says, "If there is more risk, then I want a higher return." Perhaps this seems hard for the altruistic to comprehend, but it is a simple law of economics and human behavior - adhered to by domocratic and socialistic societies alike. Some public utility regulators are saying, in effect, "We see a rise in equity investment and therefore we will reduce the return on that equity in order to keep prices down." What prudent lender would stand for such inequity without demanding a higher return on his loan or simply walking away?

Local telephone companies, once split away from AT&T, will be more intensively exposed to these problems. Immediately following the January 8, 1982 consent decree, Moody's announced that the ratings on the affected companies would be maintained at their then current level, for the time being. However, we cautioned that because the consent decree removes these companies from the "umbrella" of AT&T and limits their service offerings, that the vagaries of state regulation will become increasingly significant in the rating of their securities and that we did not expect the homogeneity of these ratings to remain intact as additional information comes to light.

With this background, I will now address our specific views on the pending AT&T consent decree relative to the Bond and Commercial Paper ratings of the wholly-owned Bell System operating companies, The Pacific Telephone and Telegraph Company and the parent company. Clearly, the environment of the independent telephone companies, the specialized common carriers, and Cincinnati Bell and Southern New England Telephone as well as Western Electric and other telecommunications manufacturers will also be affected by the decree. However, it is the Bell System operating subsidiaries and the parent which are affected most directly and to the most serious extent.

All of the wholly-owned telephone operating subsidiaries of AT&T are accorded our highest ratings. The Pacific Telephone Company has an A rating on its long-term bonds. The ratings of the telephone operating companies reflect three basic characteristics: The operations of the operating company itself; the "value" derived by the operating company from its affiliation with the entire Bell System; and the "value" derived by the operating company from its affiliation with the parent, American Telephone and Telegraph Company. The ratings on telephone companies, in general, also reflect the traditional industry business characteristics of: (1) a large lease rental revenue flow; (2) rapidly growing usage-sensitive revenue flows from long distance services; (3) high labor and capital intensity; (4) high productivity gains; and (5) limited reliance on local service rate increases due to profit flows from long distance service.

The terms of the consent decree clearly cause uncertainty with respect to a number of the underlying non-financial characteristics of the Bell operating companies which may lead to marked changes in their financial characteristics. Our concerns can be grouped into three major categories: (1) organization; (2) business and (3) regulation.

The affiliation with the Bell System and the American Telephone and Telegraph Company has provided each operating company with a number of intangible assets. First, the human resources of the entire Bell System have been available to each subsidiary as a pool of talent that could be drawn upon when circumstances warranted. Second, the technological expertise of Bell Labs and Western Electric have been directly assessible. Third, the managerial and financial expertise of the parent company has guided each company. And fourth, and most important, the financing capability of the parent has been utilized over the years to strengthen the financial posture of the operating companies. The "umbrella" of AT&T has been a very important source of credit support.

Some of the strength provided by the "umbrella" would be dissipated by the implementation of the consent decree, perhaps almost all of it. The degree of dissipation will be almost in direct correlation with the new structure of the Bell System. An $80 billion holding company with sufficient transfer of operating expertise is a structure where the least degree of dissipation would be expected. Of course, this holding company would not have the earnings base associated with Western Electric and Long Lines but ready access to the capital markets would appear a reasonable expectation.

Also, under the topic of organization, are the questions related to asset transfers. The equipment that effectively will be taken off the books of the operating companies represents a substantial investment and, given the increased rates of capital recovery recently implemented, a sizable source of future cash flow will be lost to them. The "value" of these assets needs to be properly reflected in their transfer price. In addition and, of great importance, is the effect of the asset transfers on the capitalization of the operating companies. Clearly, transfer of these assets through a balancing transfer out of equity could leave these companies undercapitalized.

Relative to our concerns associated with the "business" of the newly constituted subsidiaries, the stringent limitations on the type of services these companies could provide give rise to questions concerning their longer-term profitability. In view of the rapid technological development in telecommunications, limiting the subsidiaries to "tariffed" services could cause serious competitive problems in the long run. Already, industry representatives, including Mr. Brown of AT&T, have spoken about the potential for interexchange carriers avoiding the wired distribution system if "access" charges were to be too high. Other common carriers are already utilizing direct satellite and microwave linkages for business customers.

The removal of a significant portion of the intrastate long distance service from the operating subsidiaries can only be considered a negative. The business is priced on a usage sensitive basis, is growing rapidly and is thought to be relatively profitable. In most states, intrastate-toll has been used to subsidize local distribution. The loss of this business will shift revenue burden to the local loop and will reduce the companies' short-term ability to cope with inflation.

This brings me to regulation. Regulation, indeed becomes the bottom line, for it is the level of regulatory support provided to the companies relative to their need for incremental revenues that so importantly determines the financial posture of a regulated company. Furthermore, the history of the electric utility industry has shown that, when an industry requires continuous large increases in rates to cover ever rising costs, the industry's capability to maintain financial parameters commensurate with Moody's highest ratings becomes quite strained.

The telephone industry has greatly benefitted from the significant productivity gains achieved in the long distance services which has permitted the transfer of revenue requirements from the local distribution operations to the long distance operations. The end result has been a minimum of dependence on local service rate increases and the continuation of low rates for local telephone service.

The adoption of "cost based" access charges and the separation of a significant portion of the intrastate long distance service from the operating companies threatens the continuation of these "cost" transfers or subsidies. While the definition of "cost based" remains to be determined, continuation of the subsidy at the same levels that have occurred heretofore appears quite unlikely. In addition, the local regulators will no longer have the long distance service on which to load local rate increases-the customers will be confronted with paying substantially more for local service. This phenomenon would have occurred regardless of the consent decree. The effect of the consent decree is to potentially shorten the time frame over which the interstate subsidy will be phased out and to significantly reduce the subsidy from intrastate long distance to the local distribution system.

The reorganization of AT&T also will lead to a higher overall capital burden for the subsidiaries (unless debt is reduced by the amount of the customer premises equipment transfer) because the cash flow from customer premises equipment depreciation will not be available to fund future expenditures or to repay maturing debt. This problem would be exacerbated by inclusion of inside wiring with such terminal equipment.

In summary, the terms of the consent decree significantly change the business structure of the Bell operating companies. The loss of the parent company "umbrella", the severe limitations on the future business opportunities available to the companies, and greater reliance on increasing local service rates are of serious concern to us. In addition, several aspects of the implementation of the consent decree create a significant degree of uncertainty as to the ability of the operating subsidiaries to maintain financial postures commensurate with their current ratings. Specifically, these uncertainties include: (1) the valuation of assets which will be transferred; (2) the changes in capitalization assocated with the asset transfer; and (3) the organizational structure of the divested companies.

Mr. **Wirth**. Thank you very much, Mr. Burke.

All of you talked about the uncertainty brought about by the proposed settlement, which we all understand. How long do you expect that that uncertainty will last in the markets that you are addressing?

Mr. **Fendrich**. I think, Congressman, that there are two levels of uncertainty. One is short-term uncertainty regarding how exactly the divestiture will be accomplished and what the elements of the plan will be. That should be resolved, as I understand it, within 6 months when the divestiture plan is filed.

There are elements of uncertainty in terms of property transactions, and the degree to which Bell System's support is to be provided to the operating companies. Those two items are quite important. Any holding company or regional company structure for the operating companies would be a consideration. All that is one level of uncertainty. The second level is a long-term one. That would include any future telecommunication policy decisions both at the FCC level and in terms of legislative initiatives.

Telecommunications is an evolving technology and an evolving field. Basically, what has happened is that the utility, the telephone industry has gone from a natural utility monopoly business to a nonutility business. When you break down the telephone business, you basically have computers, wires, and terminals. We are talking about each of those areas being vulnerable to some levels of competition.

On a long-term basis, long-term telecommunication policy will be a lingering uncertainty and would affect exactly how you would evaluate ratings and credit quality of all the phone companies in the future.

What the Bell operating company arrangement does in terms of the divestiture plan in our view is that it creates for the Bell operating companies a regulated framework for those Bell operating companies, one that is legally sanctioned, and one that protects them to a large extent from competition.

The electric utility industry and gas utility industry are also vulnerable to competition in certain—in a certain sense. Yet, there is a high level of business protection. Nobody is going to go to a major city and open up a new electric utility business or a gas business. For the telephone industry, that would be somewhat similar to the local distribution company.

However, the developing economics of such things as cellular radio, or cable TV could have a longer term competitive impact on the operating companies.

Mr. **Wirth**. Mr. Barrett, Mr. Burke, would you agree with Mr. Fendrich's short- and long-term analysis of the uncertainties involved?

Mr. **Barrett**. In essence, yes. In terms of the bond market itself, one of the problems that is being faced is the investors are concerned that the operating companies will not be able to obtain sufficient equity capital during this workout process, until we know the specifics, until the whole settlement agreement takes place. It is going to be very difficult for the parent to finance debt and put in double leverage equity, et cetera, into the operating companies.

So, in that sense the markets are very wary of possible near-term financial deterioration on balance, even though the companies may be getting near-term rate relief on the local level. They are concerned that the balance sheet of the operating company itself may deteriorate.

Once this has been decided on, we will certainly know more of what is happening. One of the concerns is what will the nature of the business be for the operating company? Even though you know they will have local exchange business, what does that really mean? Will that prevent competition within the local service exchange itself? Will it prevent the cream skimming of the high volume traffic within the local exchange?

So, even though definitionally they may know, as a practical matter they may have no conclusion. So, you are going to find the bonds starting to trade at much wider spreads. You are going to find continuing less liquidity in the phone market.

Credit quality will be determined more on what the State regulatory body is like, along with the debt-equity ratio.

One of the worst things that could happen to the operating companies is the loss of financial flexibility because of the parent, who could grant them advances, master notes, and things like that.

Mr. **Wirth**. Mr. Burke.

Mr. **Burke**. I would anticipate that a great degree of uncertainty would persist for the first 6 months of planning following the decree. There might be some alleviation during the following 12-month implementation program. But still there would be extant a good degree of uncertainty. This is all barring any legislation which may be introduced or passed during that period of time. Some degree of uncertainty, but not unbearable uncertainty would exist after that, supposedly while these telephone companies were adjusting to a new environment.

Mr. **Wirth**. Thank you, gentlemen.

Mr. Bliley.

Mr. **Bliley**. Mr. Barrett, what in your opinion if anything can this subcommittee do to improve the bond rating situation for the subsidiaries, or the new corporations?

Mr. **Barrett**. As I said, I think a lot of the damage has been done. I really believe A.T. & T. will try to set up the operating companies, whatever that means, whether it will be one, or a lot, or what, with financial ratios similar to what they have now, which I believe to be inadequate. But that is an aside. I do not think anyone knows what the future business will be for the operating companies.

So, unless you know very precisely, the nature of this revenue stream it is very difficult to give any assurance to the bond holder, or even, say, to the rating agencies, as to what this might mean.

Mr. **Bliley**. Would you care to comment, Mr. Fendrich?

Mr. **Fendrich**. Yes, Congressman. Just to give you some perspective on how the analysts will eventually look at this, there is a good deal of analysis of the role of management in any evaluation of a corporation, whether it is A.T. & T. or MCI or any company in terms of the progress they make.

Mr. **Bliley**. I don't like to interrupt, but my question was, what in your opinion can this subcommittee do to improve the situation? I know what has happened as well as anybody I guess. What can we do to improve it, or can we do anything?

Mr. **Fendrich**. Your approach, of course, would be to look at the public interest. Where does the public interest lie? From a credit quality standpoint A.T. & T. has always looked at triple A credit quality being important to the nation's telecommunications needs so that they always have access, to the financial markets, to the bond markets, in order that expansion can take place on an ongoing basis.

Now, if that is still the case, that there is an important public interest for the telecommunications industry to have strong access to the capital markets, then I think a statement along those lines by the subcommittee, and that that is in the public interest, would be of benefit.

Mr. **Bliley**. It would certainly be, in my opinion, in the public interest, because the better the bond rating, the lower the debt service and, hence, the less demand on the PUC's to grant increases in rates.

Mr. Burke, would you care to comment?

Mr. **Burke**. Yes, sir. And I say this respectfully. I would hope that the Committee does not foster legislation which might make the situation a little more complex at this point in time. That is one thing I would consider. The second thing I might offer as a suggestion is that the Committee is in a wonderful position to foster formation of an unbiased and representative group or committee to assist in serving the best interests of the many various parties who are involved in this momentous event.

Mr. BLILEY. Are you saying that we should have a regulatory board of some kind to insure on a national basis?

Mr. BURKE. Well, there are so many people who are affected I suppose by this action, not only the employees of the companies, but the ratepayer of course. And from especially in my interest, the bond holder. I think each of these people should have some representation in the ultimate unbundling of this mammoth company. There certainly are people of great ability and unbiased judgment who could assist this subcommittee in doing this.

Mr. BLILEY. Mr. Burke, I don't mean to trespass on my colleague's time. Perhaps after you have had a chance to reflect on that you might wish to submit, Mr. Chairman, I ask unanimous consent Mr. Burke be allowed to do that, to submit some recommendations along that line.

Mr. BURKE. I certainly would be happy to do that, sir.

Mr. WIRTH. Without objection.

Mr. BLILEY. Thank you, Mr. Chairman.

Mr. WIRTH. Mr. Scheuer.

Mr. SCHEUER. Thank you, Mr. Chairman.

Mr. Chairman, I want to express my appreciation to you for organizing this hearing and to the witnesses for their interesting testimony. The one thing that I don't get from the witnesses is any clear directive from them as to what the Congress ought to do or what this Committee ought to do.

Mr. Fendrich, you said Standard & Poor's does not take positions on public policy issues. Could you at least suggest to us the public policy questions that we ought to be facing? What are the things we ought to be doing now in terms of legislation or in terms of hearings that would be prudent before the final shape of the consent decree emerges, and what are the other public policy issues we ought to be holding hearings on, perhaps pending knowledge of the final shape?

Mr. Burke, and that is one question, I will get all my questions in and then, for as long as we have, you can answer them.

Mr. Burke mentioned that several aspects of the consent decree seemed to threaten the financial integrity of the local operating companies. If you could tell us specifically what they are and how you would advise us to meet those problems, that would be interesting to us.

Mr. Barrett, you said that you would be against legislating if it would make an already complex situation more complex. Well, it is more complex. Do you think we ought to do anything legislatively? What are the things we could legitimately face up to now from the point of view of the integrity of the system and integrity of the bond markets?

If you could each answer those three questions briefly, I would be grateful.

Mr. FENDRICH. I believe since the divestiture plan is expected within the next few months, and its implications are large for the shape of how the local exchange companies will be structured and the telecommunications industry, and the details are not fully complete, that, once the plan is available, it could be evaluated by the Congress in terms of whether it is in the public interest.

From our standpoint, any legislation prior to the divestiture would, in the market's eyes, probably create from the investors' standpoint alone, greater uncertainty than presently exists.

And the situation is not as gloomy as the market presently paints it. But, there is uncertainty. So, anything further would create more uncertainty. The nature of the telecommunications industry will be changing a good deal, and there will be ample opportunity in terms of deciding what should actually be done.

The role of creating telecommunications policy would be to create it in as constructive a way as possible. I would simply suggest that this committee's role could be to consider the divestiture plan and its elements, the extent to which it is a viable option, and in the public interest, and perhaps also to consider any alternative recommendations, or being a clearing house to consider any possible, recommended changes.

From our standpoint, what the divestiture plan does is it telescopes the changes in the competitive area which may have taken 3 to 5 years to occur under the existing regulatory environment, and telescope that into a 1- to 2-year period. And that has benefits for the country, that is major benefits, which if the divestiture plan is in any way delayed would also have some negative public interest implications.

Mr. SCHEUER. Mr. Burke.

Mr. BURKE. Yes. The three uncertainties stemming from the consent decree which I referred to, the first two, the valuation of assets will be transferred, and second, the changing capitalization associated with asset transfer. As there are certainly very conflicting forces going head to head on these matters, I refer back again to this, for the lack of any better phrase for it, the blue ribbon committee which I alluded to before—certainly composed of financial consultants, accountants and people of this professional expertise to settle and compromise between conflicting forces.

I think this would go, in my opinion at least, a long way toward reasonable solution to the disagreements which might be involved by going ahead. The organizational structure of the divested companies was the other concern. We have our particular ideas of which might be best as an organizational structure. But, I do think that this should fall under the purview of the company.

Mr. SCHEUER. Mr. Barrett.

Mr. BARRETT. Of the problems that seem apparent, the most major would be the pressure on the local commissions to grant rate increases. The greatest impact of these rate increases will fall on the small user, the small telephone user, the one who does not use much toll calls, so that the monthly bill is primarily made up of the local service.

Their rates would go up very, very dramatically. Those are the ones generally on an economic basis who are less able to afford the increases. If someone is running a monthly bill of $70 to $80 a month, most of it being toll calls, as the toll revenues come down, the local revenues go up and there may be little net impact on the monthly bill.

However, for the retiree, or the ones in the low economic strata, they would feel the most economic impact. I think, possibly in this regard, it may be worthwhile to consider possibly phasing in, to continue some of the subsidies, in order to remove some of the tremendous political pressure on the part of the State commissions that will come to bear on them. I think one thing I have found in the past is that sometimes it is not the level of rates charged to the consumer, say from an electric bill, but it is the rate of change. If the bills go up 20, 30 percent a year, it is totally destructive. But once they get to a certain level, the consumer learns to live with that level.

So, if you could just phase in these increases more gradually, people become adjusted to it. Second, I think one of the problems is in terms of supporting the operating companies, might be in the terminal equipment area, whereby the present terminal equipment could be retained by the operating company, and the new terminal equipment would be, say with A.T. & T. This is as proposed by the bifurcated approach by the FCC, which seems to be a fairly good compromise. Third, I think one thing in terms of giving credence or credibility on the part of the investors is to prevent the operating companies from having encroachment in their service area.

Right now, the way I understand it, the operating companies cannot go out of their exchange areas, outside of their service area. But there is nothing to prevent anyone else from coming in and competing within the local service area. So, I think you might do something in that area, to prevent the cream skimming. One of the proposals a lot of the companies talk about is that, well, if they can set the access charges high enough, they could recoup some of these revenues.

I do not think that is very true because it does not prevent an independent, or a competitor, or A.T. & T. itself from coming in and just bypassing the access charges on the high volume line.

Mr. LUKEN. [presiding]. Thank you very much. Thank you, Mr. Scheuer. Mr. Tauke, perhaps, you might want to enunciate your questions before we go over for the vote.

Mr. TAUKE. Thank you, Mr. Chairman.

Mr. LUKEN. And you might then think about the answers while we are voting.

Mr. TAUKE. We have about 7 minutes to get to the floor, and to get my questions answered, so we have got to move quickly.

I really can't believe the answers that I have heard so far. You know, Mr. Bliley asked what can we do. Mr. Fendrich in all due respect, you said we ought to make a statement about how important it is that we have good bond ratings, which I doubt is going to have much impact at all.

Mr. Burke, you suggested we establish a blue ribbon committee to help us, which certainly we need all the help we can get. But, I am not sure exactly what good that is going to do either. Is that really, you know, in all seriousness, is that the best we can do? Are you telling us that we should just kind of sit by and watch the situation unfold, or is there something meaningful that we can do?

Mr. FENDRICH. Congressman, my comments regarding what can be done were addressed to what is worth considering at this time. There are a number of things, proceedings going on at the FCC.

The divestiture plan is a viable way of restructuring the industry. The committee definitely has a role in terms of analyzing in what ways it can make recommendations or hear input that would make recommendations to improve that plan.

Mr. **Luken**. Excuse me for interrupting. Mr. Tauke, you may resume your questioning when we return from the vote. And excuse me for interrupting. The subcommittee will be in recess for 10 minutes.

[Brief recess.]

Mr. **Wirth**. If the subcommittee might resume, I believe the time belongs to the gentleman from Iowa, Mr. Tauke. Do you want to recast your questions, Mr. Tauke? And you can start the clock ticking.

Mr. **Tauke**. Mr. Chairman, I thank you, first of all, for waiting until I returned, and I will be a little more diplomatic in casting the question on the return trip. Mr. Fendrich, perhaps you could tell us quite simply, do you think it is helpful, or is it not helpful if we continue to proceed to consider legislation at this time?

Mr. **Fendrich**. It is potentially counterproductive at this time inasmuch as the FCC is doing a great deal in the telecommunications area, and there is a great amount of uncertainty created by the divestiture plan. Once the details of that plan are available, a lot of the uncertainty would be going away. As far as the market is concerned, investors have concerns about as to whether and to what extent Congress may be reregulating some parts of the telecommunications business that optimally and by nature are best deregulated.

Mr. **Tauke**. Doesn't it prolong the uncertainty, though, if we wait several months to find out how all of this shakes out, and then we start talking about legislation? Wouldn't it help the situation if we would get our act together and get our position outlined and stated as quickly as possible, so that we would not keep all of these balls in the air?

Mr. **Fendrich**. There are advantages to statements and making recommendations. In terms of proposing legislation at this point prior to any of the points developed by the divestiture plan, well, that would probably be viewed as preemptive action.

You obviously have discretion to do it. It would probably be viewed negatively.

Mr. **Tauke**. Thank you. Mr. Burke, do you share that view?

Mr. **Burke**. My view, sir, on this is, if I may make a preamble statement by saying you are the legislature and your business is legislating. I am a rater and my business is rating bonds. One of the real concerns that we have in this whole situation is the dependence that these local telephone companies will have upon their regulatory agencies in their States after this whole thing is finished and done with and they are standing alone, or under some other form.

One of the important elements of the charges or the rates that they will be facing is the access charge that they can obtain. They have been subsidized on the local rate for many years now, and this is a big factor.

Another concern that we do have also is the restriction of their business simply to local, and not to intrastate local, for example, which is a relatively more profitable business.

Going back again for a moment, I am one, you know, who doesn't like to do things in a very hasty manner, as I think oftentimes when you do that, you create more problems than you solve. My allusion to this blue ribbon committee is designed, really, for full information from all different perspectives, all different involved parties, so that you can reach a determination as to what is right, what is wrong and what is maybe harmful, more harmful to one group than it is helpful to another.

If indeed you are convinced that your proper role and function in this particular matter is to put together legislation in a reasonably short period of time, I certainly would think that you would want the best advice in the world on all of these matters, and then proceed to solve, from my viewpoint, the access problem, which relates directly to one of the major concerns, as I mentioned before, how these companies are going to maintain their profit margins once they are standing alone.

That is a big chunk of this whole thing.

Mr. **Tauke**. Mr. Burke, that is my major concern also. I still am unclear. Do you think it is helpful if we move now on legislation, or do you think it is going to be harmful if we move now on legislation in terms of ratings of the bonds, your expertise?

Mr. **Burke**. All right. If indeed you are going to pass legislation and on the premise that you are, I believe that the sooner you do it, the better, as long as you are fully informed as to how much good it is going to do and who it is going to hurt.

Mr. **Tauke**. Mr. Barrett, I am not going to ask you the same question. But you did say something which really intrigued me. You said that as an aside, you believed A.T. & T. would provide inadequate financing for the operating companies. Will you elaborate on that statement?

Mr. **Barrett**. That is not exactly what I said. I have not yet met an institutional investor who would be willing to buy a new long-term bond because of the fiduciary responsibilities that they have. There may be some but I talked with about 70 major accounts around the country since this has happened. They do not know what they are buying. They do not know the entity, what the entity will look like in the face of the settlement that is imminent. Prior to settlement, the companies could market bonds. Right now, I don't know of an investor who would buy them.

I am sure if the interest rate were high enough you would find buyers, if they would be compensated for the risk. For example, most people I talk to feel that, or the conclusion is that, well, look, this is going to be like the electric utility industry with slightly better quality of earnings, because they have very short capital spending programs.

As a result, it will be between a double A and single A industry. A lot of people are talking that way. It will be an electric utility-type industry with fewer problems possibly.

As a result, if you were going to market paper, they would probably use that as a benchmark. So if one of the operating companies were to sell bonds, it would have to probably be at a level commensurate with the risks that are unknown, but somewhere along the lines of quality electric utility bonds.

The concern I am wondering about is how will the parent provide sufficient equity during this unraveling of what may happen. A lot of the operating companies need equity. A lot of the equity has been provided by infusions by the parent derived from the dividend reinvestment plan, by selling debt, et cetera.

So I think two things you are going to find is that the operating companies will be in a very difficult position to roll over their short-term debt or pay back the advances from the parent during this time, because they will find it very difficult to finance.

Second, I am not sure the parent will be willing to provide sufficient equity during this period of such uncertainty.

Mr. TAUKE. Thank you very much. Thank you, Mr. Chairman.

Mr. WIRTH. Mr. Luken.

Mr. LUKEN. Mr. Chairman, I will ask just one question, and not take up time, because I am not asking for a lengthy answer. I have missed a good bit of the testimony because I was late and because I was over voting.

But I understand that two of you gentlemen at one time or another in your testimony suggested a delay in our proceeding toward legislation because of the uncertainties, the interpretation or for whatever reason.

I wonder if you would expand on that for about a minute as to whether your advice is that Congress delay, and just how strongly you feel about it and what are the reasons, all in 1 minute.

Mr. BURKE. In less than a minute, sir, I will give it to you. I did make that statement. My concern is that in making, in formulating legislation in a hasty way, you can create a lot of problems that would continue for many, many years ahead.

Mr. LUKEN. That is always true. Let's put it to this particular situation.

Mr. BURKE. Pardon?

Mr. LUKEN. Let's apply it to this particular situation. Are the peculiar circumstances here, particularly circumstances in interpreting the agreement, or other uncertainties that are special?

Mr. BURKE. I think it is a very complex situation, and there are a lot of varied interests involved in respect to the consumers, consumers all around the country in various regulatory jurisdictions. There are some complexities with regard to asset valuation which some committee could be very helpful with.

Mr. LUKEN. Basically, what you are saying is that the spinoff plan ought to be further along or approved before we consider it, is that what you are saying?

Mr. BURKE. No, sir, that is not what I am saying. I am saying, I am really asking you to proceed cautiously, if I were to ask you for something.

Mr. LUKEN. Mr. Fendrich.

Mr. FENDRICH. Yes, Congressman. I really have no specific recommendation. There is all the flexibility to consider some major new developments that will be occurring in the next year, most notably that includes the details of the Bell divestiture plan.

Developing legislation prior to considering any details from that plan would, not be fully taking into account a major new development. And it could hold back the progress toward deregulating the telecommunications industry on a sound basis to all.

Mr. **Luken**. Do you want to have the last word?

Mr. **Barrett**. I disagree. The settlement agreements, according to the reports in the press, had been arrived at relatively quickly. And I think the responsibility of Congress is to protect, is basically to foster and extend the goals of the original Communications Act of 1934. I think they were very sound.

Given the nature of competition, that certainly has to be addressed. But I think once the settlement agreement is effected, it would be very, very difficult to go back and redo what has already been done.

I think concerns have to be addressed, with respect to tremendous local rate increases and pressures in the local press that these regulators will be under, also, in terms of the consumer himself, who will possibly suffer and not be able to afford this type of service as a small user of phone service.

I think the people who can afford it should obviously pay for the service. The people who cannot afford it should not be burdened by a dramatic and very rapid change in rates. Certainly, if they are living on the margin of their income now, you have, I think, a very basic question that has to be answered. Is telecommunications a right of each individual in this country, of each consumer?

I think that question has to be answered. Once you can answer that, you could possibly do much more. But I think this has been fostered by the original Telecommunications Act. A decision has to be made whether or not we want to turn our back on those goals and ideals. So I think legislation certainly is in order to try to foster for the public good what this would be like.

Mr. **Luken**. Thank you, Mr. Chairman. Thank you, gentlemen. I just wanted an impression. I think it has been very helpful. Thank you.

Mr. **Wirth**. Let me, if I might, respond to a couple of comments that have been made. First, I'd like to respond to the notion, Mr. Fendrich, of a preemptive act by the Congress, to use your word. I believe that we have been hearing for the last 6 years from A.T. & T. that national telecommunications policy ought to be set by the Congress, not by the courts and not by the regulatory agencies.

I would not think therefore that passing legislation would be preemptive.

Mr. **Fendrich**. Mr. Chairman, I simply meant to address a point as viewed by investors. For example, if legislation were to dictate a certain requirement for divestiture, such as the operating companies not being allowed to have any umbrella at all, whether a regional umbrella or a national association, and each operating company would have to stand on its own, then the credit quality of the operating companies could be negatively affected by legislation.

Mr. **Wirth**. Also, Mr. Burke, you are talking about hasty. We have been at this for a longer period of time than I want to tell you about. This is hardly a set of new issues that we are facing. Everything except what the local operating companies can do related to the parent, everything else is very familiar ground, whether we are talking about the access charge or where yellow pages goes, or what happens to imbedded terminal equipment or what happens to the parent in terms of the relationship between regulated long lines and unregulated Western Electric.

There are all very familiar issues to the subcommittee. The key one, the one I think you were focusing on, the one that is new, is what do the operating companies do and what don't they do?

That relates to the bond rating question, and that relates to the viability you were talking about, Mr. Barrett. A question on that. The current arrangement as I understand it, A.T. & T. advances money to the local operating companies and is able to do so because they can go into the market with an AAA bond rating and they are able to raise that money at a relatively low rate, and the local operating company benefits from that.

In return, the local operating company pays back the parent. That payback in turn goes to the dividends that are paid out to the shareholders. The local operating companies now, though, it seems to me, have the possibility of catching it in both directions.

One, their ability to raise that money, it is going to be more expensive for them to raise that money because they are not under, as you pointed out, the A.T. & T. parent umbrella.

Second, their risk is higher and their cost of money if probably higher, the dividends they have to pay out are probably going to have to be higher, right, to insure people are going to invest in that, which is going to put an extra burden on the operating companies compared to what we have now.

Is that a fair analysis? And if so, what do we do about that, if anything?

Mr. BARRETT. I think that is a very accurate statement. One of the worst things that is going to happen to the operating companies is the loss of the parent and the financial flexibility. When there is a bad market, the company still has the dividend reinvestment plan, so they have a cash flow coming in. They can avoid terrible times in the market and advance money to the subsidiary.

That flexibility would no longer be there for the operating company. I think one of the best illustrations of the clout of this is for PACTEL last year when they, after not receiving equity from the parent, I believe they received $600 or $700 million of equity, because the parent thought it was worth it for them to put it into that company.

This will no longer be available. No company can raise that kind of equity, no telephone company. Yet, it was available to that company when the need was recognized on the part of the parent.

I think the flexibility of the Bell subsidiaries will be impaired. The cost of not having an implicit guarantor available will make the scrutiny on the part of the lenders of moneys much more strict.

And I think the cost of funding would go up for the operating company. I am not sure what you could do about that once you split them up. Some people mention you can set up another holding company for the operating companies themselves.

That would do it, but one of the great things, you know, going back in history, A.T. & T. itself has been the only one to sell commercial paper and had bank loans. They distributed that to the operating companies because they had their own businesses. Then they allow the operating companies to arrange their own financing in addition.

So this is a transition period that had gone on. The first one, the main one, the bulwark of the national security system would be gone to a great extent.

Mr. **WIRTH**. Would it be helpful to the operating companies in terms their ability to compete in the marketplace at reasonable rates not only to have the access charge Mr. Burke has talked about, but also to keep in the local rate base Yellow Pages and imbedded terminal equipment?

Mr. **BARRETT**. I think the Yellow Pages and terminal equipment would be—it might be very good to keep in for the operating companies. Second, I think as far as the access charges go, the problem I see with that is that there is nothing preventing A.T. & T. or other competitors to circumvent those in order to go in and skim off the high volume traffic. Unless you can prevent someone from coming into the local service area—if the access charges are too high, people will just avoid them. I think that is one of the problems you have. I think one of the things you can do with the legislation would be possibly to slow down this process, so that if there are major changes, you take some of the pressure off the State commissions.

Don't put them in a political box of having to go out and increase rates 50 to 100 percent over a very short period of time. They like their jobs also.

Mr. **WIRTH**. I think the gentleman from Iowa would want to pursue that question of restrictions on local operating companies.

Mr. **TAUKE**. Mr. Chairman, you already covered it. But Mr. Burke spent considerable time talking about the access charge and how important that was to the future viability of the companies and their bond ratings. Does the imposition of restrictions on the ability of the operating companies to offer certain services, does that have as large a role on the viability of those companies and on their future bond ratings?

In other words, if we have them the opportunity to pursue different kinds of services, not at this point being able to be specific about that, would that be helpful to them in terms of their bond ratings and their ability to get credit?

Mr. **BURKE**. It would be important. The intrastate toll business, for example, as I said before, is somewhat a better business than simply the local call. This would be a plus for the operating subsidiary. As to whether it is a bigger or a lesser plus than an appropriate access change is debatable.

Mr. **TAUKE**. But it is significant?

Mr. **BURKE**. Yes, it would be a plus for the operating subsidiary.

Mr. **FENDRICH**. Mr. Congressman, I believe there would be a neutral effect because there is sufficient flexibility with the access charge and there will be for a number of years to come, so as to provide that subsidy to local users, whether structured within the local exchange company, or within a Bell subsidiary.

It is simply a matter of structure. The problems of the ratings and credit quality of the local exchange company will not go away once you have a divestiture, because once you have a divestiture these companies will be standing on their own, and they will ultimately be regulated by their State commissions.

Also, on the matter of higher rates, for consumers. Rates for consumers will not go up for the customer any more on this basis in terms of a divestiture plan than they would have anyway as you move to a more competitive environment.

The only way they would be going up more than proportionately is if lower credit quality forced higher financing costs.

Mr. TAUKE. Mr. Fendrich, it occurs to me that one of the major problems of the operating companies or local service companies, whatever we call them, one of the major problems of those companies, that they face, is that they are operating in a limited universe, if you will, of services.

And somebody else can come in and in a sense take those services away from them by offering alternatives. And so, they have an ever-diminishing base of operations, if you will.

The old central theory as someone has suggested. Is that not one of the problems we face with bond ratings?

Mr. FENDRICH. That may be a problem down the road. That requirement was placed into effect as I understand it at the insistence of the Justice Department. The consent decree could be amended down the road in the future to change that requirement. My assumption as an analyst is that somewhere down the road that could well be the case.

Mr. TAUKE. Mr. Barrett, do you have a comment?

Mr. BARRETT. I think that if Congress were to allow Yellow Pages to remain with the operating company, I think it would be very helpful. I think intrastate toll business would be very helpful for the operating companies. What it would do would give the bond-buyer a more clear view of the business, of the revenue stream available for the debt service.

One of the arguments used on the part of A.T. & T., I believe, of this in justifying the settlement agreement is that the assets remaining for the operating company are the lines going into the houses, and the switches going from house to house and nobody wants to get into that business, and it is a relatively stable business, et cetera.

That is good if my wife calls her friend down the block. Nobody wants that business. That is not the high margin part of the business that could be stripped away, though. So I think something has to be done to prevent the business as defined from being stripped away.

I think intrastate tolls is something that is very, very important to—would be very important to try to diminish the negative impacts.

Mr. TAUKE. Thank you. Thank you, Mr. Chairman.

Mr. WIRTH. Are there further questions to be asked of the panel?

Mr. BARRETT. Mr. Chairman.

Mr. WIRTH. Mr. Barrett.

Mr. BARRETT. I think one other point that has not been addressed and I think that should be addressed would be the possible impact of a rapid settlement on the part of the independent telephone companies. I think particularly the small independent telephone companies could be very, very vulnerable.

Those companies which derive 70, 80 percent of their revenues from toll service could be in financially dire straits if this were to take place. Some way a net has to be put under these companies, mergers have to be mandated or something to prevent service from deteriorating completely.

I think you will find if that were the case that the first negative impact would be one of service for these companies. I don't think this is something that is socially acceptable.

Mr. **Wirth**. I would be very leery about defining safety nets these days.

Let me ask one final question, if I might, Mr. Barrett.

You were talking about the potential of cream-skimming in the area of the operating companies, that the parent might be able to come in and take all the big users off of the local loop, which would further denigrate the ability of the local operating company to raise capital.

Mr. **Barrett**. Correct.

Mr. **Wirth**. There are restrictions that are placed on the local operating companies under the settlement. There really aren't restrictions placed on the parent company.

Mr. **Barrett**. That is as I understand it.

Mr. **Wirth**. Does your statement than argue that the parent company should not be allowed to come into the local loop and compete with the local operating companies for that major flow of traffic that you referred to earlier?

Mr. **Barrett**. I think by not allowing the parent or any competitor to come into the local loop, it would certainly solidify or make more predictable the earnings of the operating companies.

Predictability of earnings is what would make a bond holder happier.

Mr. **Wirth**. Cellular radio for example, should that be a service offered by the operating company rather than the parent?

Mr. **Barrett**. By the operating company.

Mr. **Wirth**. That issue is, I think, a very important one.

Mr. **Barrett**. I think so, also.

Mr. **Wirth**. That goes to Mr. Burke's concern also about what happens to an access charge. If you raise the access charge too high, then you will find users really trying to avoid paying for the charge. So you have to attempt to keep it down. One of the ways you attempt to keep the access charge down, it seems to me, is to balance that off by focusing on other services the operating companies can offer, such as Yellow Pages, equipment, and so on. In this way, you do not provide the kind of perverse incentives to users to go off the local network altogether, which would in the long term be damaging for us as a country in terms of a cohesive telecommunications network.

Mr. **Barrett**. I would agree 100 percent.

Mr. **Wirth**. Mr. Burke, you are on the edge of your chair.

Mr. **Burke**. Yes; may I just add one thing on the last comment. It has always been my opinion that the existence of regulation is predicated on an absence of competition. If others are allowed to come in and compete and take away the business of a company in a given regulated franchise, I don't see any consistency in that combination.

Mr. **Wirth**. Well, we talk about long distance being a marketplace that has a few competitors involved. But it is hardly a competitive situation yet where you have over 96 percent of the long distance market controlled by Bell and its affiliate.

Mr. **Burke**. Of course.

Mr. **Wirth**. I think you are correct in drawing a distinction between a truly competitive marketplace and some competitors coming into a marketplace dominated by one firm. There is a lot of difference between those two.

Mr. **Burke**. Exactly.

Mr. **Wirth**. Thank you all very much for being with us. We greatly appreciate it and your patience in being here.

Joining us on our next panel is Mr. John Carroll with the Communication Workers of America and Mr. Anthony Salamone, assistant to the president at IBEW. Mr. Carroll and Mr. Salamone, thank you for your appearance. We are delighted to have you here.

Mr. Carroll, perhaps you could start. Thank you very much. You might introduce your colleagues at the table for the purposes of the recorder and the panel, and then go right ahead.

STATEMENTS OF JOHN C. CARROLL, EXECUTIVE VICE PRESIDENT, COMMUNICATIONS WORKERS OF AMERICA, AFL-CIO, ACCOMPANIED BY JAMES BOOE, EXECUTIVE VICE PRESIDENT; AND ANTHONY J. SALAMONE, ADMINISTRATIVE ASSISTANT TO INTERNATIONAL PRESIDENT, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS

Mr. **Carroll**. Mr. Chairman, I am an executive vice president of the Communications Workers of America. My primary responsibility is coordinating collective bargaining matters for all of our people represented in various bargining units in the Bell System.

The proposed consent settlement between the Government and A.T. & T. provides us with still another example to prove the old maxim that "the only constant is change." The proposed settlement will have a major effect on the way we bargain for and represent our membership. One key benefit of the proposed settlement will be to remove communications policymaking from the courts.

Recently, President Watts sent an official request for bargaining to A.T. & T.'s top management, in order to rationalize our processes and to prevent grave morale problems from developing within our membership now employed within the A.T. & T. group of companies.

For the last 2 years, the leaders of CWA have been aware of members' morale problems, starting with the April 1980 FCC decision in "Computer II" and the legislative activities on both sides of the Capitol.

Men and women who have spent many years in the telephone industry somewhere within A.T. & T. have found themselves enmeshed in a process involving Government and company, a process few of them had perceived as having a direct effect on their lives.

Unfortunately, much of what I can tell you today is speculative. We and everyone else must await the submission by A.T. & T. of its specific reorganization plan. As of today, we believe legislation in the 97th Congress is needed, especially with employee protection provisions, which to our members means job security. We are examining the employee provisions in your bill, H.R. 5158, and in the Senate's act, S. 898, to suggest any changes we think are needed.

Since 1974, CWA and other unions have negotiated with A.T. & T. on a national basis. What we have bargained nationally in wages and benefits is included in and supplemented as necessary in the local or area bargaining unit agreements. In CWA, there are 34 such local agreements, covering the operating companies, Long Lines, the several parts of Western Electric and Bell Telephone Laboratories. It took our union about 35 years to secure national bargaining, which has been a key element in the high degree of labor peace within A.T. & T.

Today, we see the probability of a new three-way split in our bargaining, which will without doubt have a serious effect on our operations on behalf of the members for some time. One arena of bargaining would be within the new A.T. & T.; a second arena would be within the fully separated subsidiaries to be created and owned by A.T. & T.; and the third would be in the new local dial-tone operating telephone companies to be spun off by A.T. & T.

This last category would consist of the present 22 Bell majority-owned operating companies, excluding the minority-owned Cincinnati and Southern New England companies.

We have no way of knowing if the 22 operating companies will continue to bargain nationally, regionally or separately; the proposed consent settlement sets no optimum number between 1 and 22. From paragraph B in the first section of the proposal, we learn that the new operating companies may have a centralized organization for numerous and generally unspecified services; we hope labor relations will be a part of such a centralized operation.

Our best estimate is that 50 to 60 percent of the bargaining unit jobs in the present operating companies will go to the new, spunoff dial tone local exchange carriers.

In numbers within CWA, this 50 to 60 percent means a range of 195,000 to 235,000 men and women who on divestiture day begin working for some new employer or employers. We have many open questions today, including how to ease the transition in such important matters as pension rights and levels of benefits; net credited service or sometimes referred to as seniority; collective bargaining representation and recognition; job bidding and posting.

We are aware that many witnesses at the congressional hearings held since January 8 have expressed concern about the economic health of the newly constituted local exchange carriers, the present Bell operating companies.

This very real concern must be communicated by interested parties to Judge Greene in terms much less shrill than we have been hearing in recent weeks.

The Congress needs to ensure this health through exchange access charges adequate to pay the true value of services received; we believe the non-Bell companies are properly concerned that access charges may not sufficiently replace the present yields from separations and settlements.

Existing provisions of H.R. 5158 and S. 898 on equipment procurement and trade reciprocity must be very carefully examined by the Congress, to avoid unintended consequences. The two pieces of legislation create a quota system on equipment, which means almost inevitably that foreign producers will have a U.S. Government-blessed entry into the market, which translates into sending still more jobs overseas.

You and we are most painfully aware that to date, Nippon Telegraph & Telephone Public Corp. has granted only two small contracts to American suppliers. We understand that NTT is considering a divestiture similar to that proposed for A.T. & T., by a spinoff of local exchanges. NTT would effectively remove from coverage of the Government Procurement Code most of the commercial opportunities supposedly offered the United States in the December 1980 agreement between our country and those overseas. We believe legislation is urgently needed here.

Mr. Chairman, we believe cooperative efforts will help ensure that the consent settlement creates a better and more fair competitive environment, while also providing for the best interests of the 1 million Americans employed within A.T. & T.

Mr. WIRTH. Thank you.

Mr. Salamone.

STATEMENT OF ANTHONY J. SALAMONE

Mr. SALAMONE. Mr. Chairman, members of the committee, I have with me Robert Stander, an international representative out of our manufacturing department, responsible for the Western Electric bargaining units, and to my right, Robert Nickey, responsible for the A.T. & T. negotiations. The IBEW represents 1 million members, several hundred thousand of them are employed in the telecommunications industry. I am here today to voice the concerns of President Pillard regarding the impact of the proposed A.T. & T. settlement on our members.

We appreciate the concern which this subcommittee has shown for the employees who will be affected by the impending changes in this industry. We are aware that H.R. 5158 contained language to insure the economic security of employees who would have been affected by the proposed legislative reorganization.

However, we are now facing a very different game plan. The proposed settlement embodies a completely different view of the industry than that which had been proposed in various bills introduced in the past few years.

Yet, there is no mention in the proposed settlement of any employee protections. We are therefore grateful for this opportunity to present our concerns about the impact of the settlement on telecommunications employees.

As representatives of these employees, we have our own agenda against which we have attempted to evaluate the proposed settlement. However, we are at somewhat of a loss, because the settlement has raised more questions than answers. I would like briefly to outline the general employment concerns of those of our members who will be affected by the settlement, and then to list some of our many questions regarding the future of the industry which must be resolved before we can evaluate the impact of the proposed settlement on these employees.

Telephone employees have enjoyed a history of collective bargaining, which has secured them stable wage rates, seniority rights, pension benefits and advancement opportunities. Indeed, the attraction of the industry has been its stability.

Individuals affected by the settlement will want assurances that the rights they have earned will be safeguarded. Securing such assurances will be no easy task, for we are dealing with employees at all stages of their careers, and in all parts of the industry. Some are employees of the Bell operating companies who will be separated from the Bell System.

Others are Bell Operating Co. employees who will be transferred to A.T. & T. Longlines. Still others are engaged in parts of the industry whose future status is as yet undefined.

We have begun meeting with representatives of A.T. & T. to attempt to address some of these concerns. However, many of these problems fall outside the scope of negotiations. Moreover, until we have a clearer view of what the industry will look like, we will be unable to effectively negotiate.

Which brings us to our major question. What form will the industry take? In brief, some of the many uncertainties we face are as follows: What will the divested operating companies look like? Will there be 22 individual companies, one large one, or several regional ones? What services will they be able to provide? Will those services insure that customers get full basic telephone service? Will those services provide revenue to assure the companies' viability? What assets will they start out with? Will the assets be sufficient to guarantee continued viability? What effect will the deregulation have on the imports market and how will imports affect the viability of parts of the industry?

As you can see, our questions are varied. However, all center on a concern for the continue integrity and viability of the telecommunications industry. Our concerns in this regard are twofold.

As consumers, our members want assurances that the promise of the 1934 Communications Act—basic telephone service at affordable rates—will not be compromised. As employees, they want assurances that the restructured companies will start business in the telecommunications industry with the means and potential to grow and develop.

The settlement proposal has provided the bare outlines of what the future structure of the industry will be. Until the questions outlined above have been answered, we will be unable to assess fully what the true effect will be on our members as employees in the industry and as users of telecommunications services.

Thank you.

[Mr. Salamone's prepared statement follows:]

Statement of
Anthony J. Salamone,
Administrative Assistant to the International President,
International Brotherhood of Electrical Workers

Mr. Chairman and distinguished members of the Committee, my name is Anthony J. Salamone. I am the Administrative Assistant to Charles H. Pillard, International President of the International Brotherhood of Electrical Workers. The IBEW represents several hundred thousand employees in the telephone industry. Our members are employed by operating telephone companies, by telephone interconnect companies and by companies that manufacture communications equipment. It is as a representative of these many employees engaged in all aspects of the telecommunications industry that I am here today to voice the concerns of President Pillard regarding the impact of the proposed AT&T settlement on our members and on telephone employees generally.

I would like to begin by recognizing and expressing our appreciation for the concern which this Subcommittee has shown for the telecommunications employees who will be affected by the impending changes in this industry. We are aware that H.R. 5158 contained language designed to ensure the economic stability of employees who would have been affected by the proposed legislative reorganization. However, we are now facing a very different game plan. The proposed modified consent decree embodies a completely different view of the industry than that which had been put forward in H.R. 5158 and in various other legislative proposals made over the past few years. Yet, there is no mention in the proposed settlement of any employee protections. We are therefore grateful for this opportunity to present our concerns about the impact of the proposed modified consent decree on employees in the telecommunications industry.

At this point, the proposed settlement has raised more questions than it has given us answers about what the structure of the industry and the identity of its corporate participants will be. Accordingly, I would today like to discuss the questions and concerns which this proposal has raised for our members. To outline our concerns, I will focus on two separate but related issues. First, I will discuss the general nature of our members' concerns as employees in this industry. Second, I will discuss our questions regarding what the structure of the industry will be after the settlement is implemented, and the specific concerns these questions raise for our members. The uncertainties as to how the proposed settlement will actually be implemented must be clarified before we can assess its true impact and focus on the measures which will be required to assure the affected workers employment security.

First, I would like to outline the general employment concerns of our members who are currently employed by AT&T and the Bell operating companies, or BOC's. At the present time, each of the BOC's has collective bargaining agreements with representatives of established bargaining units. These collective bargaining agreements are the result of a history of negotiations, and provide guaranteed wages, seniority rights, pension benefits, and health and welfare benefits. In addition, these bargaining agreements spell out work practices and advancement opportunities. Employees who have been with these companies for any length of time have earned seniority benefits, transfer rights, and other priviliges as a result of their accrued service. They want to know that they will not lose these rights. In addition, the unions have earned recognition from the companies, and have been certified by the NLRB. Of course, the unions are interested in preserving these earned rights.

Employment with the BOC's has also provided employees with certain lines of progression, giving them opportunities to advance. Some of these advancement opportunities are part of planned upward mobility programs. Employees who have been looking forward to opportunities to advance within the industry want to know what opportunities will remain available to them.

Thus, as a general matter, these are our areas of concern: For the unions and their members, preservation of certification rights and bargaining units; for the individual employees, preservation of earned wage rates and seniority rights, pension and welfare benefits, and employment opportunities. Chairman Brown of AT&T testified before this Subcommittee that collective bargaining agreements now in effect provide preservation of accrued rights and benefits for the employees who will be affected by the anticipated corporate change. However, the provisions to which he referred do not fully answer all of our concerns. These provisions provide guarantees for employees transferred to new affiliates or divisions of AT&T. However, a significant part of the situation we are now facing involves separations from AT&T, or transfers to existing departments of AT&T. With this in mind, I will now address the specific questions which have been raised, but not answered, by the proposed settlement.

As we see it, employees currently employed by the BOC's will be directly affected in three primary ways. First, employees engaged in providing exchange telecommunication services at the BOC's will no longer be Bell System employees. Second, employees engaged in certain interexchange services who are presently employed by the BOC's will become part of AT&T's Longlines Department, and will be separated from the BOC's. And third, there are employees who cannot predict whether they will be in the regulated or unregulated sector of the industry, or what other effects the proposed order will have on their jobs.

For the first group, those who will be employed by the newly created operating companies, the biggest uncertainties center on the identity and structure of the new employers. The settlement proposal provides that the operating companies may be separated into one or a number of companies. At the present time, we have no clues as to what form the new employers will take. Whatever the structure of the new company or companies, the affected employees face uncertainty as to whether currently existing bargaining units will be left intact, divided or combined, whether collective bargaining agreements in effect at the time of the transfer will be honored, and whether their individually-accrued rights will be recognized.

A second area of concern for our members employed by the operating companies is what services those companies will be able to provide and what assets will be left with the companies. The settlement as now drafted allows these operating companies to provide only basic telephone services, and sets forth no requirements concerning the amount of assets AT&T must leave with the companies. Our members want to know whether these companies are going to be given the authority to provide the kind of services and left with sufficient assets to keep them viable. Their concerns in this regard stem from both their status as consumers, who want to be able to depend on continued provision of basic services, and as employees, who want to know that their employer will be a viable entity.

The second group of affected employees will be those now employed in that portion of the long distance network currently operated by the BOC's which will be transferred to AT&T Longlines. It is possible that these employees may enjoy some contractual protections as transferees within the Bell System. However, even this is not clear. Moreover, this corporate reorganization will entail removing individuals from many bargaining units now established at the BOC's, and placing them in a corporate department which presently is recognized by AT&T as a single nationwide bargaining unit. This existing unit is currently far smaller than the group which will be added into it. Our members want to be assured that the employees transferred to Longlines will maintain their current bargaining representatives.

The third group consists of employees whose place in the industry is as yet undefined. A major group falling in this category consists of workers currently employed in installing and maintaining embedded wiring. It is unclear from the settlement proposal whether installation and maintenance of embedded wiring will remain a function of the operating companies. Our members want to know whether embedded wiring will be deregulated and, if so whether installation and maintenance services will be provided or whether customers will be expected to service themselves in this area. Again, our members have two major concerns in this regard. As customers, they want to be assured that if embedded wiring is deregulated customers will still have available the basic maintenance services that they need. And second, as employees, they want to know what employment opportunities will be available to them if these services are scaled down.

Other employees are also in facing uncertainty about their place in the industry, as a result of the unclear interaction between the proposed settlement and the FCC's Computer II inquiry. The Computer II decision, like the legislative proposals referred to earlier, anticipated that deregulation would occur in a very different form than that required by the modified consent decree. Parts of the Computer II decision are currently scheduled to be implemented by January, 1983, and plans had been set in motion to reorganize parts of AT&T in compliance with that decision. Employees caught in the interface between these two plans - especially those in manufacturing - want to know what effect the settlement will have on the FCC's decision and on the reorganization which was to have followed it.

In summary, telecommunications employees are facing corporate reorganization, and anticipate a period of disruption and flux in the industry. They are concerned about what will happen both to their earned employment rights and their earned representation rights. As consumers, they want assurances that the promise of the 1934 Communications Act - basic telephone service at affordable rates - will not be compromised. As employees, they want assurances that the restructured companies will start business in the telecommunications industry with the means and potential to remain viable. The settlement proposal has provided the bare outlines of what the future structure of the industry will be. Until the questions outlined above have been answered, we will not be able to assess fully what the true effect will be on our members as employees in the industry and users of telecommunications services.

Thank you.

Mr. **Wirth**. Thank you very much, Mr. Salamone. Let's just take a brief minute and review the timetable we are operating under here. I understand that the 60 days under the Tunney Act starts ticking as soon as the competitive impact statement is submitted.

Mr. **Salamone**. As I understand it, that is correct.

Mr. **Wirth**. That was to be done last Friday, and has been delayed in the budget, but it is going to be submitted at any time, is that correct?

Mr. **Carroll**. My understanding is that the 60 days started February 19, starts the 19th.

Mr. **Booe**. The judge is going to enter it, right.

Mr. **Wirth**. Let's say at the end of February the 60-day clock ticks. At the end of the 60 days, Judge Greene has a period of time in which he can decide what to do about the proposed settlement. That can be a day, 10 days, 30 days, whatever. At the end of whatever that indeterminate period of time is, then the 6-month planning period starts, correct?

Mr. **Salamone**. Correct.

Mr. **Wirth**. So we have 60 days from the middle of February to the middle of April, then another undetermined period of time, then a 6-month period of time. That takes us pretty much up to the first of the year, plus or minus about a month.

The Congress will be in session this summer. Then we will go out for the holidays, rest up until the first Tuesday of November, and then come back for a lameduck session. That is a good deal of legislative time. Is it your opinion that the Congress ought to be acting on legislation during this period of time, or should we wait until the next Congress, or not act at all?

Mr. **Carroll**. From my viewpoint, Mr. Chairman, we have been talking about doing something about the Communications Act of 1934 since 1976. All of the things that have come forth about what is going to flow from the divestiture as a result, and as they relate to subscribers, were there back in 1976 on any type of competitive aspects.

We feel that legislation is needed in three major areas. First being employee protection, which is in our own bailiwick. Second, protection for the residential rural subscribers in the area of rate raises and access. And a redirection of the FCC of the 1934 act, changing it from a monopoly operation to a competitive operation. As the timetable you outlined about what would be happening, if we don't soon have some legislation, it may be too late in this year.

Mr. **Salamone**. Our contracts expire in August 1983. We will probably negotiate what we can in the area of mandatory bargaining. However, there are areas of concern we have that may not be properly addressed. There is no question we think they ought to be dealt with by the Congress. I confine my remarks to employee protection. I am not competent to talk about the money market or bonds or whatever they are. But we think you need to go ahead. Because we need to have a set of rules that we are going to negotiate those agreements under and we might as well have them when we enter those negotiations.

Otherwise, we are going to be limited in our negotiations with regard to where do we extend these benefits. There is nothing to protect the employee. We can negotiate with A.T. & T. We can negotiate agreements, benefits, pensions, and otherwise, but they will apply specifically to that company. They wouldn't apply to new entities or new employers which is really what the spinoff would be, unless we have some employee protection in the legislation.

Thus, the new employers are going to be created, then you limit us as to what happens to our members when the new companies are formed.

Morever, we are concerned that there are other regulated carriers, other than A.T. & T., we seem to lose sight of that. There is an awful large group out there of telecommunications employees that work for other than A.T. & T. and Bell Telephone. But we are concerned about them because these companies will choose, I am sure, to restructure their organization to compete in the marketplace that has been created now by this modified consent decree. So that is a long answer.

The short answer is yes, I think you need to proceed with legislation, confined to employee protection. I will let the other people who are competent talk about the other matters.

Mr. **Wirth**. You both agree we ought to go ahead with legislation, focusing on employee protection. Mr. Salamone also said to go ahead and set the rules within the context of which we are bargaining.

Mr. Carroll, you made other points on protection of residential and rural subscribers, hardly a new issue. And redefining the role of the FCC is again, hardly a new issue. Both of these issues have been thoroughly heard and addressed over and over again.

So we wouldn't be accused of acting hastily. We have been around the block any number of times. It is my own sense that we should get on with it. Just on the employee-protection matter, are you currently discussing your concerns with A.T. & T.?

You alluded to this briefly in your testimony. Do you anticipate as a result of those discussions that you might be in a position to be able to make recommendations to the Congress as to what the legislation ought to address?

Mr. **Carroll**. In relation to discussions with A.T. & T., yes, we anticipate we will probably have some discussions, formal or informal, somewhere down the line. But whatever flows from those discussions will not necessarily cover the areas of concern that we have relative to the protection of the employees we represent, not only in the Bell System, but also our concern about the 148 independent telephone companies we hold contracts with wherein we represent something in excess of 60,000 employees.

Make sure that whatever happens in the divestiture does not have an adverse effect on those employees we represent also.

Mr. **Wirth**. Mr. Salamone?

Mr. **Salamone**. Well, when it comes to employee protection, I would like to confine my remarks to that. I might also get into affordable basic services. I am familiar with what is in the current H.R. 5158, which addresses the areas of employee protection.

It addresses how they are carried over, if they go into a new company, and how they will transfer the pension benefits over, and some of the things they will be entitled to. It starts to define what transferees are, what terminated employees are, et cetera.

The lexicon of terms in that employee protection section really are the things we are concerned about, and they express it very, very well. In another very controversial area, now I am going to say exactly what I said I wouldn't do, and that is talk about something other than employee protection. If you are asking does the IBEW believe that local dial-tone companies should be permitted to engage in more than basic services, you know, should you address that in legislation, well, I take a very simplistic view of that because of the employee protection.

That is, the local dial-tone company can't make it, if it is not a viable company, then perhaps somebody has to look at some other source of revenue for them.

I don't know whether you expand their services or what. Whatever the case may be, I am concerned about keeping the company viable and working. Why? So the employees will have jobs, you see. That is employee protection, too, in a left-handed way.

Mr. **Wirth**. Mr. Scheuer?

Mr. **Scheuer**. Mr. Chairman, the hour is getting late. I know you are waiting for a subsequent panel so I am just going to ask this panel one question. I would like to direct it at Mr. Carroll.

Mr. Carroll, you testified that, as a result of this consent decree, jobs would be exported. Is that right? You fear jobs would be exported, capital would be exported. And I think that is a concern every single one of us has in this country.

We have seen the Japanese and others outcompete us and whipsaw us all over the world in steel, automobiles. Now we are faced with the same phenomenon in telecommunications. We are faced with some real giants over there, Toshiba, Sony, Hitachi just in

Japan, Siemens in West Germany, Ericsson in Switzerland, Telecom in Canada.

They are a formidable group of competitors. They are large, they are very well financed. Sometimes there is government assistance and sometimes not. It gives them their financing spanning a decade or decade and a half. They don't have to look to the securities market, justify their financing based on profits each quarter.

They have a lot of built-in advantages going for them. I think we are very much concerned about the export of jobs and capital. Of course, you have to be, too, because you are talking about hundreds of thousands of jobs. If we can't compete in telecommunications, what hope is there for the rest of our industry? Telecommunications, this high technology, the state of the art is where we should shine, where American labor and American capital should really show our competitive moxie. What specific suggestion have you got for us in terms of either legislation, or examining the implications of the consent decree that would unleash the major corporations to compete successfully in global competition, and what action do you think we can take right now in the short run, and what action do you think may have to await the final form and shape of the consent decree?

Mr. CARROLL. That is a very complicated question to respond to. But I will try and at least respond to part of it. I think they ought to make sure that whatever legislation is passed, that it gives each one of the corporations or companies, whichever you want, an equal opportunity to compete, and not that one, because it is larger than something else, should be restricted because it is big from entering and competing in fields, in the entire field of information.

In the situation relative to Japanese competitors, they have a different type of structure in their government. I just don't see how our Government can subsidize a company so it can compete worldwide as is done in Japan.

Mr. SCHEUER. Are there any structural changes you could point to that we ought to be looking at in terms of the consent decree to remove any impediments to American success in competing globally? We are talking about employing hundreds of thousands of American workers. What changes do you see us making in the current landscape, both the proposed legislation we are looking at, 5158, and also in the consent decree?

What do you think we can do? Would you like to see any changes in H.R. 5158? Would you like to see any changes in the consent decree to make possible employment of more workers, healthy and tough and competitive American corporations competing successfully around the world?

Mr. CARROLL. I will have to respond in this area. In the relation of H.R. 5158, my primary concern has been the area of employee protection.

Mr. SCHEUER. That is what I am talking about. We are talking about a lot of jobs for a lot of American workers. We want that job pool to grow, not to diminish. We don't want to export jobs. What should we be doing to make sure we don't export jobs and capital and talent?

Mr. CARROLL. As I understand the consent decree, if accompanying legislation and decisions of the FCC release all competitors to compete evenly, I think they can do it well.

Mr. SCHEUER. Anybody else?

Mr. SALAMONE. Congressman, the threat of imports, specifically from Japan, is real. It is so real that I don't think there are too many people that appreciate it. The modified consent decree, I think, opens up the market to that. I don't know how many people are aware of cellular radio systems, they have had it in Japan. They make no bones about it. It is as good as what we have been experimenting with for 13 years here while they have been developing it.

They are just waiting to bring it over and start putting it on our market. What can you do about it? Sound like a protectionist, if you will. But I think it is employee protection. H.R. 5158 I think gets into some kind of a quid pro quo sort of thing, that is if the Japanese market doesn't open up to imports, then we don't open up for imports or vice versa.

I think that is a start. I think that is where you really have to put some teeth into it. My concern is we write all of these things. I have been involved in color television and saw it go away. But then how do we enforce it? We really write beautiful language about the quid pro quo, write nice language about opening up foreign markets? But then we wake up and sure enough, American jobs have been exported.

Mr. SCHEUER. Just to put a footnote on that, Reubin Askew, on behalf of our Government negotiated a Government procurement code that would assure us the same access to Japanese markets that they have to ours.

It is just being very laboriously implemented. I understand Nippon Telephone and Telegraph is engaging in a divestiture which would effectively remove it from the coverage of that new code. So again, one of the greatest purchasers in the world of telecommunications equipment would be out from under that, in effect, fair access code we negotiated over many, many years and would be free to erect the same traditional barriers that have kept American competitors out of Japanese markets while we frequently give them access to our markets. It is just awfully frustrating.

Mr. SALAMONE. It is.

Mr. SCHEUER. I think the most favored nation principle applied to access to markets is long overdue here. I think that is something we could probably all agree on. Is there anything else any member of the panel can suggest that we look at, or any action we could take to insure competitiveness of our telecommunications corporations in global trade?

Mr. CARROLL. No, sir.

Mr. SCHEUER. Thank you, Mr. Chairman.

Mr. WIRTH. Thank you very much, Mr. Scheuer. Just on that front, I believe that in the divestiture of NTT along with a number of other properties, NTT has agreed to comply by the government procurement procedure in Japan. Just because NTT was spun off does not mean they do not have to comply with the agreements that have been reached.

Mr. **Tauke**. Just a couple of brief questions, Mr. Carroll, and Mr. Salamone, both, I understand you are trying to talk to A.T. & T. Apparently, there really isn't a lot at this juncture that can be expected from those conversations. But I am wondering if maybe you are talking to each other, A, and B, if there is any hope that the two of you might be jointly submitting some suggestion to this subcommittee about what kinds of employee protection provisions you would like to see in the legislation.

Mr. **Carroll**. It would be my viewpoint that our organization will be submitting some suggestions to the committee.

Mr. **Tauke**. Jointly with your counterpart, Mr. Salamone? Have you had any conversations? Yes, being rather blunt, suppose somebody is transferred from the CWA to a IBEW local? How is this going to be handled, or vice versa?

Mr. **Salamone**. Congressman, we are not inhibited in any way about who we would submit it with or what. We have submitted employee protection suggestions to this committee. We will continue to do so, singularly or jointly.

Are we talking together? I think the record will have to speak for itself. Our agreements are similar if not identical over the years. Do we publicly conduct coordinated bargaining? No.

Mr. **Tauke**. I am wondering if you might just, trying to make it easier for us, if you might have some joint or parallel recommendations to the subcommittee.

Mr. **Carroll**. I might say this: In the area of employee protection, I don't think we have a difference of opinion.

Mr. **Tauke**. How does this work out? If somebody is stranded in their job as a result of this shuffle from—basically are doing the same service but get transferred from one local to another, how does that work out?

Mr. **Salamone**. Some of the protection items in H.R. 5158, along with the labor agreements, provide that they take along with them what is the keystone to everything, their accredited service, and with that the attendant pension benefits, welfare, vacation, holiday, they will take with them. There are some time frames in which this has to happen, and that they have to be transferred in. There is also a definition of a terminated employee and a transferred employee.

Mr. **Carroll**. We negotiated a successorship agreement in our 1980 negotiations to take care of the anticipated transfer to new entities which were going to be part of A.T. & T. It does not apply itself directly to divestiture.

Mr. **Salamone**. Therein lies the problem with new companies. That is why I think we need employee protection. When we are dealing with A.T. & T. under the FCC and the legislation, they called them everything from fully separated affiliates to I don't know what. But they had all kinds of titles.

That was fine because we were dealing with new entities, Baby Bells, FSAS, et cetera. Under the modified consent decree, we are not dealing with that. We are dealing with a company now that is going to spin off 22, one, two, whatever, different companies and new employers.

There is nothing to protect us in transferring our contractual rights under the bargaining agreements to that new company. The only law that really protects us in any way is we do transfer our bargaining rights under the National Labor Relations Act. That doesn't mean we take the agreement with us.

Mr. **Tauke**. Thank you both very much. Thank you, Mr. Chairman.

Mr. **Wirth**. Mr. Luken.

Mr. **Luken**. Yes; Mr. Carroll, I want to congratulate you on your statement. You certainly have a great deal packed into a few words. I would like you to amplify a little bit. You say the two pieces of legislation, referring to H.R. 5158 and S. 898 create a quota system on equipment which means that almost inevitably the foreign producers will have a U.S. Government-blessed entry into the market.

I would like to go into this for a minute, this question, of foreign competition. I would like to ask you both, have you already experienced amongst your members a loss of jobs due to foreign competition?

Mr. **Carroll**. To some degree, and we almost experienced one, a very, very vital one, if you remember, the Japanese company initially announced a contract before the new loop on the east coast. Subsequently, they rethought the position and awarded it to Western Electric. As far back as 10, 12 years ago, when I was vice president of Communications Workers out in the Mountain States area, we had jobs taken away by the importation of Japanese central office equipment at that time.

Primarily because the Mountain Bell Co., at that time could buy them cheaper from Nippon Electric Co. than they could locally, except that the particular piece of equipment was not then in development in this country.

Mr. **Luken**. It is principally prospective, the loss of jobs, is that right?

Mr. **Salamone**. Not necessarily. I think we have experienced some loss of jobs. What can be attributed to technological impact and what can be attributed to actual imports is probably pretty difficult to define. Certainly, our bargaining units have been reduced in numbers.

I don't think it is all technological impacts that has caused that. So it has to be something else. Telephone numbers keep going up. Somebody told me there was something like 142 million telephones in the country. It is not a matter that people aren't buying. Something is happening and there is importing by small telephone interconnect companies that came into being, fostered under the Carter phone decision.

I venture to guess probably 90 percent of the equipment they install is foreign-made equipment. So, yes, there is that effect.

Mr. **Luken**. So that is what happened in brief up to now. Now, if we pass H.R. 5158 or S. 898, we would be introducing, Mr. Carroll, a quota system, meaning what?

Mr. **Carroll**. My understanding, if it is correct, is that there is a quota which the companies must purchase equipment from other suppliers than Western Electric. That opens the door for any foreign competitor to come in and supply the equipment, which would mean if that is supplied there, the manufacturer of the equipment, the jobs of manufacturing equipment in this country are not going to be there to the extent they are.

The handling of the equipment from the manufacturing plant to the sale and distribution, jobs in that area are not going to be as numerous as they are. The sale of terminal equipment is certainly going to be a competitive aspect, and the Nippon Electric Co. certainly would be introducing theirs into this country.

At what competitive price, we don't know.

Mr. **Luken**. Is it a fact that the competition for Western Electric has been principally, and is expected to be, foreign competitors? Is that the idea?

Mr. **Carroll**. It is possible. Not totally, no. But that certainly opens a door, that foreign competitors can come into that market.

Mr. **Salamone**. I agree. It is an open invitation, really, to them. It more than opens the market. It is an open invitation for them to come in and start to sell equipment, et cetera, to Bell operating companies, who can't go anywhere. They are restricted, inhibited by the quotas they have.

They have to buy somewhere. They start buying out on the market, the Japanese, we say Japanese although there are others as well, come in and it is an open invitation on the market. It is going to cost us jobs.

Mr. **Luken**. I am assuming it is an integral part of the statement that you have made, Mr. Carroll, that Western Electric has been the principal domestic supplier in this area.

Mr. **Carroll**. Basically, that is correct.

Mr. **Luken**. Almost exclusively.

Mr. **Carroll**. Exclusively, not necessarily totally. But it has been a major supplier of the Bell System. It has not necessarily been a major supplier of the telephone companies.

Mr. **Luken**. In certain areas of equipment, heavy transmission equipment, isn't it particularly true?

Mr. **Carroll**. I would say in the main it has been mostly Western Electric equipment in the past.

Mr. **Luken**. Who else would be able to meet that demand for heavy transmission equipment if the new operating companies had to go outside of Western Electric?

Mr. **Carroll**. A number of companies Mr. Scheuer mentioned just a few moments ago are all capable of producing that type of equipment, and are doing so.

Mr. **Luken**. Those companies being Nippon.

Mr. **Scheuer**. Toshiba, Okiy, Sony, Hitachi, Ericsson of Sweden, Siemens of West Germany.

Mr. **Salamone**. But there are also some American companies that really could start to fill in that gap. Wescom, Rockwell International is expanding. Lenkurt, GTE, which is in an expanding state, could start to meet that demand.

I think up to now they have not tried to expand in the market because there was no marketplace. If 96 percent of the telephone business was A.T. & T. and they were buying their equipment from Western Electric, then it would be foolish for those money managers and corporate gun slingers to take their money and start investing it in those areas. They would end up with no jobs.

Mr. Luken. Would they have the capacity, these American companies, to meet the demand if this quota system were imposed? Would that be a question early on?

Mr. Salamone. I think they will. We have a bargaining unit right now in New Mexico that is quite a large plant of Lenkurt. We have some GTE plants that have substantial bargaining units and capacity. I am sure they could, given the money, given the capital and equipment. Sure.

Mr. Luken. Those are the questions. I am trying to determine the factual situation which is included in the statement. I would not pursue it any further. Would you want to comment further, Mr. Carroll?

Mr. Carroll. No.

Mr. Luken. I yield back.

Mr. Wirth. Thank you, Mr. Luken. I should also point out, Mr. Carroll, as I am sure you know, that the intent of the legislation is to attempt to move toward more open procurement. The purpose of that is that the best way to compete overseas is to have a variety of competitors at home who could compete overseas. The more competitors we have, the more likely it is we are going to penetrate foreign markets. That is the rationale for this.

Historically A.T. & T. refused to get into those foreign markets. Until other firms began to get in, we did not have anybody competing in those markets. A.T. & T. had a captive market at home. Why bother to go overseas? So we attempted to open procurement for the purpose of stimulating that kind of competition.

One of the questions was, what level of outside procurement was necessary? The Senate had one level, we had a different level. In our legislation, if the FCC finds that there is no American supplier who can meet that level, A.T. & T. does not have to go about procuring competitively.

The purpose was to stimulate competitive entries at home, not to stimulate foreign penetration from abroad. I think that is important to point out, Mr. Carroll. I thought that in reviewing your testimony, you did leave out an important element of what is in the legislation, which in fairness ought to be balanced out. This point has Mr. Luken concerned, justifiably, about an open invitation to foreign competitors to barrage our market with equipment.

That is not the intent. The intent is to encourage domestic competition. That is what presumably we are all about in this equipment area.

Mr. Carroll. I am aware of your viewpoint, Mr. Wirth.

Mr. Luken. If the gentleman would yield, that may not be the intent. But it very well might be the result. That is the question we are looking at. My mind certainly is not at ease that it would not be the result simply by the precautions that you have indicated.

If we go down through the testimony we talk about GATT and protections of the government procurement code in Japan. I am not, in view of our experience in the past with the Japanese, I am not at all satisfied or content with the idea that American companies would get a fair shake on balance in Japan simply because of a government procurement code, because there would be marketing systems and other systems in Japan which might very well frustrate it.

Mr. **Wirth**. The gentleman raises very legitimate issues. I wanted to make sure we all understood what was there and what the intent was.

Mr. Markey.

Mr. **Markey**. Thank you.

Mr. Carroll, on page 3 of your testimony you say that there is reason to have great concern about the economic health of the newly constituted local exchange carriers presently known as the Bell operating companies. This very real concern must be communicated by interested parties and Judge Greene in terms much less shrill than we have been hearing in recent weeks.

One of the problems all of the members of the subcommittee have been having over the last three weeks since the settlement was announced is that there is a real schizophrenia on the part of the local bell operating companies that the local executives really do not know who they work for any longer. Yet, they still seem to be taking orders from the mother company, although he long-term interest of the local operating companies might not be consistent with the objectives of Ma Bell in their negotiations with the Justice Department in the coming months in trying to flesh out the actual details of the settlement.

You say that interested parties should go to Judge Greene. What I am wondering is, are you planning on going to Judge Greene? Are you going to make a presentation? If so, are you going to be able to resolve that identity crisis, because you must have the same kind of problem to a certain extent. That you have members who are going to be on either side of these questions, depending upon which part of the overall corporate structure they now work for and which direction they are heading in.

I was just wondering if you could tell us how you are trying to resolve that, and be able to go in and make the best case for both sides, and make sure the people who are going to be on either side of this case, because there indeed are people on either side of this case who are members of your unions, both unions, I am sure, that are not going to be served by broad generalization. They need real advocates in their fighting for their interests in this suit.

Mr. **Carroll**. Mr. Markey, it is the intent of the communications workers of America to submit some comments to Judge Greene. At the moment, what area they will be in, we have not concluded our thoughts on that yet. But we intend to submit comments.

Mr. **Markey**. Has the IBEW made up their mind?

Mr. **Salamone**. We have not. But we are not at all optimistic that Judge Greene or the modified consent decree is going to address employee protections at that point. Because the settlement they reached is the short form settlement. It is really ambiguous. We do not know where they are going, the complexion of the bargaining units, et cetera.

So it would be difficult for them to address employee protection.

Mr. **Markey**. Does that give you a real problem, knowing your workers might be split off into, some remaining with the mother company and others broken off?

Mr. **Salamone**. No question.

Mr. **Markey**. Are they inconsistent to a certain extent? Do you have a problem in trying to synthesize the interests of these now diverse company interests? There are, let's say for the sake of argument, you have the mother company and two different competing interests. We are trying to get more assets for one, Yellow Pages, installing local telephones, all the rest of this stuff, where the jobs are over here, the benefits, the extra revenues, the extra pension protections, everything will be built in over here, also goes that way.

Does that give you any problems?

Mr. **Salamone**. It does not if you realize what our mission and charter is. That is to forcefully and honestly represent our members whether they be in the spring of their career, the summer of their careers, the fall or winter of their careers. So that does not give us any kind of a problem. We honestly, forcefully, and fairly represent them, whether they be with Ma Bell or with XYZ Co.

Mr. **Markey**. I just mean in the consent decree itself. After the consent decree is set down, there will be clearly an opportunity to go in and negotiate as best you can with the assets the entity has been given to get the best deal you can for them. But before that, in order to make sure there is fair and equitable distribution of the assets, the resources, are you going to enter into that deliberation? Are you going to set forth a set of proposals so we will have guidance?

I think that is going to be very important for us because we want to do the right thing in formulating legislation, to make sure we are in a position to give those assurances to workers on either side of the fence. You split the league. You are making national leaguers and American leaguers. You have played your whole career in the American league and really are not that familiar. But we have to make some tough decisions to give you that protection.

I know you are going to give them all the protection in the world once the decision is final. But many of the decisions will be made and will be beyond your control in the next 6 months. That is really I think what our concern is.

Mr. **Salamone**. If I may, Congressman, my statement goes right to the issue. Our concerns are the viability of those operating companies, whether they be 22, 2, 1, or whatever that serves the best interest of our members. I might also tell you we are a little discouraged, maybe inhibited from going to Judge Greene.

We understand he has three options. He has the option to approve the modified consent decree or not to approve it. The third option is to suggest to the parties, Department of Justice and A.T. & T., that they make certain modifications. He cannot make them. So I do not know what we would gain by going to Judge Greene. I do know what we would gain in our up-coming negotiations if we have employee protection under legislation and we have the ground rules to what we negotiate and the areas where we can negotiate.

If we have the rules we can play the game whether it be American league or national league. That will be immaterial.

Mr. **Markey**. To a certain extent future salary negotiations will probably be contingent upon the profits that any of these now individual Bell operating companies are able to generate. You cannot drain blood from a stone. The decision as to how profitable any of these individual entities are going to be in the future will depend upon what kind of assets they are given as they are going in.

We have found a real chilling effect has taken hold of the officers of the Bell operating companies. That they are not forthcoming with testimony that is at significant variance with the testimony of the mother company.

Clearly now there are divergent interests. What we are really looking for and hoping you might be able to offer us is that kind of independent insight and judgment as to what you think might be a fair and equitable distribution of these resources.

Would you be able to put that kind of analysis together for us?

Mr. SALAMONE. I am sure we could when we talk about viability of the companies. The workers' concern is just as much as the executive out at New England Telephone that does not know where he is going, what happens to his upward mobility, whether he is now going through an A.T. & T. 3-year rotation thing that is not going to be available to him.

Let me tell you, you take that and multiply it, if you will, down to the little old blue collar worker who starts out as an installer, and who saw an upward ladder going up and now you are crushing that ladder on him, yes. The concerns are greater than that of the executive. I may be sorry I said this. Executives have some potential employment that a lot of our people might not have. They have some potential financial capabilities a lot of our people may not have.

So their job security and way of life is a little bit different. I guess we could probably look in that area. It goes down, bottom line is, as long as it is a viable company, the simplistic view is it will stay and grow in business. As long as it grows in business, then we can negotitate fair wages, hours, and working conditions.

Mr. MARKEY. Could you do that for us as well, Mr. Carroll, is that possible?

Mr. CARROLL. I think that might be possible. My own personal comment, that particular area is outside of my expertise. That is the best answer I could give you today.

Mr. MARKEY. You do not know whether or not you could give us that information?

Mr. CARROLL. That is outside my personal expertise.

Mr. MARKEY. You could submit it and have others within the organization submit it to the subcommittee?

Mr. CARROLL. I could not respond affirmatively today to you.

Mr. MARKEY. Does H.R. 5158 adequately address your employee protection problems?

Mr. SALAMONE. I do not think it does now. We have a new ball game. We had some problems in some small areas I thought we could get over before you got the legislation passed, but I think now it does not address them entirely with the modified consent decree. I think it needs to be looked at again.

Mr. MARKEY. Mr. Carroll.

Mr. CARROLL. I have the same opinion. It does not address itself to divestiture, only to emplyees who are transferred to another entity of the Bell System.

Mr. **Markey**. We have a rollcall on now. But would you both be able to submit to us your recommended language for inclusion in any bill we pass for coverage of the employee protection questions?

Mr. **Salamone**. Congressman, you cannot keep me from doing it.

Mr. **Carroll**. We would be happy to.

Mr. **Markey**. Great. That would be very helpful.

Mr. **Wirth**. Fine. Thank you both very much for being with us. We look forward to hearing from you and working with you. We have a vote on now followed by another vote, so it will probably be about a 15-minute hiatus here before we go on with our next panel on competitive impact.

Mr. Salamone, Mr. Carroll and company, thank you very much for being here. We will see you soon. Thank you.

[Brief recess.]

Mr. **Wirth**. The subcommittee will come to order.

Thank you very much for your forbearance. Our third panel this afternoon, which focuses on the competitive impact of the settlement, includes four distinguished witnesses: Mr. William McGowan, chairman of the board of MCI, Mr. Fred Lafer, vice president and general counsel of Automatic Data Processing, Inc., Mr. William Forster, vice president, ITT, and Mr. Michael Morris, general counsel of ROLM Corp.

Thank you very much for joining us and for being with us this afternoon. Perhaps the appropriate thing to do would be just to start from your right and move across starting with Mr. McGowan. I think you know what the rules and procedures of the subcommittee are.

STATEMENTS OF WILLIAM G. McGOWAN, BOARD CHAIRMAN, MCI COMMUNICATIONS CORP.; FRED S. LAFER, VICE CHAIRMAN, ASSOCIATION OF DATA PROCESSING SERVICE ORGANIZATIONS, INC.; WILLIAM H. FORSTER, VICE PRESIDENT, INTERNATIONAL TELEPHONE & TELEGRAPH CORP.; AND MICHAEL H. MORRIS, SENIOR ATTORNEY, ROLM CORP.

Mr. **McGowan**. At the beginning of my abbreviated remarks I would like to make a statement. Someone, a number of years ago, violated the antitrust laws of the United States. They were found guilty by several juries. The United States of America brought a suit against them in 1974. They were within 3 months of settling it. The judge said that the U.S. Government has proved that A.T. & T. has violated the antitrust laws of the United States in many ways over many years.

That was the driving force for the settlement, and this consent decree I believe removes the major cancer in the industry that has caused the antitrust violation, that one company had control over a vital resource. The policy expressed in the consent decree is the right policy, that you either are in a competitive mode and therefore you can be deregulated or will be deregulated as soon as competition has a sufficient share of the market, or if you are in a monopoly mode where you control the vital resource that other people need, you should not be allowed to be in competitive businesses.

While many of us may quibble with the details, settlement of the Government's case against A.T. & T. has set in motion a fundamental change in this industry, of the most dramatic, long-range, and positive sort.

As it stands, the settlement cures the principal cause for Bell's continuing violation of the antitrust laws, and it cures the resistance of this industry to normal technological advancement and competition.

Since A.T. & T. has recognized that this cannot go on, a rational restructuring of the industry is inevitable.

Now, a hue and cry has been raised that consumers will be hurt by the end of Bell's stranglehold on their phone bills. Incredibly, it is assumed that massive, irrational, largely secret internal flows of funds back and forth within the Bell System are giving all customers a free ride on their local phone service—including every Fortune 500 company, and every other business in America. There are more than 28 million main or equivalent main business telephones in the Bell System.

Home telephone users today account for 70 percent of all long-distance traffic and 55 percent of long-distance revenues. If they are subsidizing anyone's local telephone bills, Congress should immediately pass a law against it.

However, I predict that in the near future people will be asking themselves why they ever believed that the most economically and politically powerful corporation in this country has really allowed 40 percent of its business—local telephone service—to be offered at a loss. I do not believe it is.

With this settlement, and with investigative work which has only recently been done, we now know several things which call that issue a red herring.

My written submission points to expert testimony, introduced by the Government, which shows that—using Bell's own cost methodologies—local revenues do meet their direct costs and do contribute to the common costs of the business. Out of 21 States in which the Bell method has been applied, local service requires no subsidy in 14, and that includes Colorado, Massachusetts, New York, Virginia, and Washington. In six States, local service was shown to be below cost only because Bell artificially and irrationally categorized non-traffic-sensitive costs as local direct costs, whereas in the other States such costs were treated separately.

I point as well to a new distributed cost study done by the North American Telephone Association, which finds Bell's exchange services to be profitable.

Both studies demonstrate that Bell's competitive private lines and terminal equipment do not meet their costs, and the NATA study shows that the revenue shortfall would more than absorb the total amount of the alleged subsidy—leaving nothing to subsidize local rates.

In 1980, the supposed subsidy from interstate services amounted to $3.8 billion. The intrastate shortfall in equipment and private-line revenues was $3.99 billion. After the decree, customers of the operating companies will be relieved of the burden of Bell's subsidized terminal equipment and private-line services.

The second thing we now know is that the consent decree will interrupt flows of money and service from the Bell operating companies to A.T. & T., flows which provide the opportunity for reverse subsidization.

The decree will end A.T. & T.'s ability to mandate the purchase of equipment from Western Electric—at what William Baxter has called very fancy prices. In 1980, those purchases amounted to $10.2 billion.

The decree ends the operating companies' dividend payments to A.T. & T., a substantial portion of which may be used as retained earnings by the parent. Those dividends and interest payments were $4.5 billion in 1980.

There can be no more mandatory license contract payments, worth $1.3 billion to A.T. & T. in 1980.

Importantly, the operating companies will no longer be responsible for the dregs of the long-distance plant, which has costs per circuit mile 600 percent higher than Long Lines, that plant used in intrastate.

The cost of marketing Bell's long-distance service and equipment will no longer fall on the local companies, and A.T. & T. can no longer demand that the cost of billing for long-distance be assigned 100 percent to local service.

Finally—and this is most important—the settlement means an end to A.T. & T.'s present strategy of insisting that the Bell System's burden of increased profits, increased costs, and accelerated depreciation be loaded almost entirely on local exchange rates. They will not have that power any more, and the single greatest threat to local phone rates will therefore be removed.

In conclusion, I would estimate that the net effect of these changes will be positive for competitors and home telephone users alike, if the decree is properly implemented. In the process, the mythological free ride for local ratepayers will be shown for what it is: Created out of whole cloth, beginning in 1973, for no other purpose than driving competition before the winds of political reaction.

I appreciate this opportunity to testify.

[Testimony resumes on p. 452.]

[Mr. McGowan's prepared statement and appendix follow:]

Testimony

of

William G. McGowan
Chairman of the Board
MCI Communications Corporation

Settlement of the Government's case against AT&T has set in motion a fundamental change in this industry, of the most dramatic, long-range, and positive sort.

Of course, we must realize that what has taken place is the negotiated settlement of a lawsuit. As such it is a compromise between the parties. I might have done it differently. Congress might have done otherwise. Judge Greene might have reached a different conclusion regarding appropriate relief. It is the latter prospect, I believe, which forced Bell to the negotiating table.

However, as it stands, the settlement cures the principal cause for Bell's continuing violation of the antitrust laws, and it cures the resistance of this industry to normal technological advancement and competition.

That cause was the single control, by one small group of people, over all facets of what will be, in three years, a 120 billion-dollar industry.

The unfortunate fact is that holding an entire, major American industry in the palm of your hand does not automatically make one any smarter or any more honest. Rather, it magnifies the damage done by unwise decisions or improper actions.

AT&T has now admitted what everyone has known. It is possible to function well in the long distance business without also dominating local exchange services, as MCI is demonstrating.

It is also possible to be a local service company without also controlling long distance, as 1,500 independent telephone companies do every day.

Since AT&T has recognized these facts, a rational restructuring of the industry is inevitable, regardless of what happens to this pending settlement. The process of reform is irreversible.

Now, a hue and cry has been raised that consumers will be hurt by the end of Bell's stranglehold on their phone bills.

Incredibly, it is assumed that massive, irrational, largely secret internal flows of funds back and forth within the Bell System are giving all customers a "free ride" on their local phone bills -- including every Fortune 500 company, and every other business in America. (There are more than 28 million main or equivalent main business telephones in the Bell System.)

AT&T says it uses long distance revenues to subsidize all local service rates. Home telephone users account for 70 percent of all long distance traffic and 55 percent of MTS revenues. If they are subsidizing any business's local telephone bills, Congress should immediately pass a law against it.

However, I predict that in the near future people will be asking themselves why they ever believed that the most economically and politically powerful corporation in this country has really allowed 40 percent of its business to be offered at a loss.

With this settlement, and with investigative work which has only recently been done, we now know several things which call that issue a red herring.

First, while it appears to be the case that AT&T's largely urban customers do subsidize the independent telephone companies which serve the rural and remote parts of this country, the evidence is contrary to Bell's claim that AT&T's own local customers benefit from such subsidization.

Divestiture will put an end to Bell's very ability to make that claim, which is based on a cost-accounting shell game which blurs the distinction between local costs and others.

Second, divestiture will relieve the Bell Operating Companies (BOCs) of burdens they now bear: the most inefficient part of the long distance plant, and subsidized, money-losing customer premise equipment and business private line services.

Third, divestiture will end massive flows of funds from the BOCs to AT&T, flows which carry the opportunity for reverse subsidization.

I want to discuss in more detail some of the abuses which divestiture will end -- to the benefit of home telephone users.

Ended: The Burden of Subsidized Equipment and Services

On January 19, 1982, the North American Telephone Association filed with the FCC a new study which, in place of AT&T's manipulative "cost methodologies," uses procedures which allocate Bell System costs on a more rational, fully-distributed basis.

The outcome of that study is summarized in the three charts below, which are part of NATA's FCC submission. In general, they show Bell's local exchange services to be profitable, earning an 11 percent rate of return in 1980 -- and they corroborate what has repeatedly been demonstrated over the years: that Bell's customer premise equipoment and business private line revenues are deficient.

SUMMARY OF MONOPOLY PROFITS

THE AMERICAN TELEPHONE AND TELEGRAPH COMPANY
FULLY DISTRIBUTED COST STUDY
TWELVE MONTHS ENDED DECEMBER 31, 1980

BILLIONS OF DOLLARS

	Total Company	Exchange Service	State Toll	State P.L.	Cust Prem Equipment	Vertical Services	Interst Toll	Interst P.L.
Net Operating Income	$ 8.0	$ 3.5	$ 1.6	-$.09	-$ 3.9	$ 0.4	$ 6.4	$.07
Net Investment Base	$93.5	$31.9	$12.4	$6.1	$18.3	$1.0	$20.2	$3.5
Rate Of Return	8.5%	11.1%	12.5%	-1.5%	-21.1%	40.0%	31.4%	2.0%

FIGURE 1

BELL MONOPOLY SERVICES ARE PROFITABLE

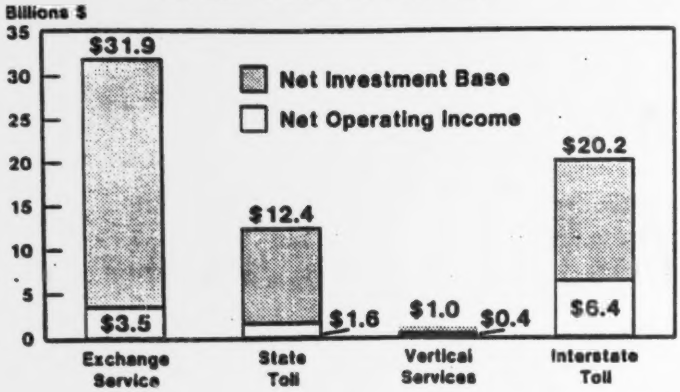


FIGURE 2

BELL COMPETITIVE SERVICES ARE NOT PROFITABLE

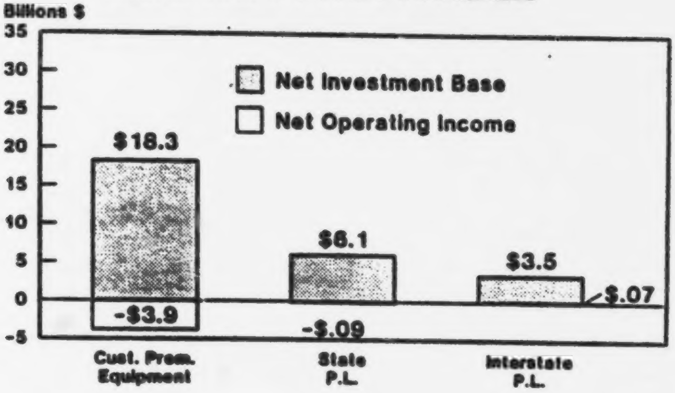


FIGURE 3

It is difficult to overestimate the impact of NATA's findings on Bell's claim that a "subsidy" flows from interstate revenues, past all of the BOCs' competitive intrastate operations, to its totally monopolized local service business.

Even assuming that such a net subsidy exists within the Bell system the shortfall in customer premise equipment and state private line revenues would more than absorb the entire amount of the alleged "subsidy."

1980 "Subsidy" Amount to BOCs	1980 CPE/Private Line Revenue Shortfall
$3.7 billion	$3.99 billion

NATA's cost study shows a revenue deficiency of $3.9 billion for customer premise equipment, and $.09 billion for state private line service.

The "subsidy" amount is calculated from AT&T's March 1, 1979, submission to the FCC in Common Carrier Docket No. 20981, in which Bell estimated the 1980 Bell System non-traffic-sensitive costs assigned interstate to be as follows:

Total NTS Costs	Interstate SLU Factor	Interstate SPF	NTS Costs Assigned Interstate
$21.610	7.38	24.29	$5.400

(Dollars in billions)

In that submission and elsewhere, Bell identified the "subsidy" as being the difference between assignments using SLU (Subscriber Line Usage) and SPF (Subscriber Plant Factor). From the above figures, it is clear that SLU would allocate $1.595 billion in costs to interstate operations, while SPF allocates $5.249 billion. The "subsidy," or SPF-SLU difference, is then $3.654 billion. (The relatively minor discrepancies in AT&T's application of these percentages is unexplained.)

This accepts, for the sake of argument only, AT&T's claim that the Division of Revenues process more than adequately compensates the BOCs for the welter of plant and support rendered by them to interstate services, and that the SPF-SLU difference quantifies the "overpayment."

Accepting that dubious conclusion, the impact of NATA's results is obvious: if what Bell says about a subsidy flowing from interstate to intrastate is true, the "subsidy" would be more than absorbed by Bell's underpricing of customer premise equipment and private lines, and there is nothing left over to subsidize local rates.

Properly drawn and implemented, the forthcoming consent decree can intervene most positively in this situation, by getting the BOCs out of the business of renting terminal equipment, and offering private line services, at a loss.

Ended: Flows of BOC Funds to AT&T

Given the underpricing of CPE and BOC private line services, the decree would clearly accrue to the net benefit of local exchange ratepayers.

One must add to that, moreover, the decree's interruption of money flows from the BOCs to AT&T, which presently give AT&T the opportunity to carry out its obvious motives, to gain subsidy flows from -- not to -- the operating companies.

Two of these opportunities have been commented upon by Assistant Attorney General William Baxter in testimony before both Senate and House committees: the license contract payments and BOC equipment purchases from Western Electric.

License contract payments made by the operating companies in 1980 were $1.3 billion. 1980 equipment purchases by the BOCs were $10.2 billion.

The thrust of Mr. Baxter's argument is that such payments may well offset any SPF-generated subsidy flow. In his testimony before the Senate Commerce Committee on February 4, 1981, Mr. Baxter said, of the license contract payments, "My view is that the fee is too large and has siphoned revenues from the operating companies that ought to have stayed there."

The consent decree will end these payments.

Of the equipment purchases, Mr. Baxter said, "Operating companies are under considerable pressure to make equipment purchases from Western Electric [and] are paying unnecessarily high prices."

Obviously, since Western Electric dividends are paid 100 percent to AT&T, the parent can benefit from any monopoly profits extracted from Western Electric's captive market, the BOCs.

Under the terms of the settlement, the BOCs will be free to purchase from non-AT&T suppliers, at rates which cannot be enforced by AT&T.

These two items do not exhaust the list of money flows from the BOCs to AT&T.

A major item which cannot be forgotten are dividend payments to AT&T, which amounted -- with interest payments -- to $4.5 billion in 1980.

These dividends are not paid to AT&T stockholders. They go to AT&T itself, providing the parent with significant retained earnings.

Under the decree, those dividend payments will cease. Dividends will be paid to BOC stockholders, not the AT&T Treasury.

Ended: BOC Operation of High Cost Plant

The evidence so far indicates that the alleged "subsidy" does not flow to local rates. If it exists, it may simply serve to keep BOC equipment and private line prices below cost in the face of competition. If it exists, it may well be more than offset by BOC overpayments for Western Electric equipment, by the license contract fees, and by dividends paid to AT&T.

Both possibilities will be blocked by the decree. However, the idea that a subsidy exists in the first place remains unproven and highly suspect.

This is because AT&T remains uniquely positioned to directly offset any SPF-generated overpayment by undercompensating the BOCs for other cost or expense items.

While the facts of this matter remain obscured in the "division of labor" between the BOCs and Long Lines for interstate operations, two quantifiable pieces of evidence serve to cast doubt on the supposed "generosity" of payments to the BOCs for their part of the burden.

First the BOCs are not compensated as "generously" as non-Bell local telephone companies are, through the separations and settlements process. Per interstate MTS/WATS message, the BOCs are paid much less than the non-Bell companies. For 1980, the results were as follows, according to AT&T data:

	Total Interstate MTS/WATS Payment	Messages Originated	Payment Per Message
Independents	$2.1 billion	1.180 billion	$1.80
Bell Companies	$12.4 billion	8.630 billion	$1.44

For this lower level of reimbursement, the BOCs do substantially more than the independent companies. While the latter provide, primarily, for the origination and termination of interstate traffic, the BOCs also operate the lion's share of Bell's long distance plant -- and the least efficient portion.

According to the 1980 Bell System Statistical Manual, Long Lines has only 18.4 percent of the plant assigned interstate. The rest is carried by the BOCs. (It is unclear whether the BOC share includes all or only some of the non-traffic-sensitive local plant assigned interstate.)

The interexchange plant operated by the BOCs has costs per circuit mile fully 600 percent of that owned by Long Lines. Over the years, claimed reductions in these costs have benefitted Long Lines far more than the BOCs.

From AT&T's response to Information Request No. 15, Joint Board proceeding in FCC Docket No. 80-286, we can see the following pattern:

Book Cost per Circuit Mile
Interexchange Circuit Plant

Year	Long Lines	BOCs
1960	$32	$106
1965	25	90
1970	19	72
1975	16	70
1980	11	66
Reduction	65.6%	37.7%

The consent decree will rectify this imbalance by untangling the joint provision of interexchange service by Long Lines and the BOCs. The terms of the settlement require AT&T to assume all of the long distance cost burden.

Once that is done, we shall discover whether the BOCs are "generously" reimbursed for their part in interstate operations, whether the reimbursement actually includes any net "subsidy," or whether the opposite is true: that the BOCs are paid less than the independents for orginating and terminating interstate MTS/WATS messages, while they must operate the inefficient dregs of the Bell System long distance plant.

Ended: Loading Cost Increases on Local Service

In 1980, AT&T's operating companies suddenly quadrupled -- to $4.5 billion -- their usual annual demands for state-level rate increases. Since then, the level of Bell's demands has risen still further.

The nationwide pattern of these state rate applications has been equally arresting. In most cases, the operating companies have insisted that these rate increases be loaded overwhelmingly on local exchange service.

Southwestern Bell's recent rate application in Texas (Docket 3920) is exemplary.

In June, 1981, Southwestern Bell filed the largest rate application in Texas history, seeking $469 million in new revenues. This BOC proposed to allocate $407 million, or 87 percent, to local exchange rate increases.

The company proposed only modest increases in terminal equipment or private line rates -- even though its own cost data showed Southwestern Bell was losing money on them! The company proposed no increase in state toll rates. This puts in correct light Bell's claim that "competition" is making local rates go up: they have competition for equipment, toll, and private lines; they have none for local service.

In fact, the company sent a circular to all its Texas customers, blaming the local rate increase on "competition." At a press conference, Southwestern Bell executives were even more specific: competition from companies like MCI was to blame.

Under oath before the Texas Commission's hearing examiner, Southwestern's lead witness, Vice President Paul Roth, stated repeatedly that not one dollar of the rate increase was because of revenues "lost" to competition.

Instead, he was quite specific about the causes of the rate increase:

	Cause	Amount
1.	Expensing station connections and accelerated depreciation	$ 69 million
2.	"Inflation-related" cost increases	$200 million
3.	Increased rate of return, from 14.1 to 17.1 percent	$160 million
4.	Increased cost of debt	$ 40 million
	Total	$469 million
	To be recovered from local rates	$407 million

The audacity of all this is breathtaking. It should be clear to anyone that faster depreciation, more profit, more expensive debt, and inflation should affect all of Southwestern Bell's lines of business: terminal equipment, local exchange service, and the long distance services.

These items are in no wise the exclusive responsibility of local telephone users. Yet, incredibly, that was assumed.

Clearly, no exchange ratepayer should be required to pay more until Southwestern Bell's money-losing equipment and private line services are earning the allowed rate of return. But, there is competition in these areas; that option was ignored.

The impact of the consent decree in this regard can be as positive for local ratepayers as anything the settlement requires.

Once divestiture has taken place, the effects of inflation, of accelerated depreciation, and increased profit on Bell's equipment and long distance offerings may not be shifted to local service.

In no way can AT&T demand that nearly the whole burden of the Bell System's increased cost be loaded on local exchange rates. AT&T will no longer own the business.

Ended: The Rationale for Local Rate Increases

AT&T's excuse for loading the Bell System's increased costs onto local service is simple: local exchange revenues do not meet their costs. Local service, they say, is grossly revenue deficient (and subsidized from interstate toll). Therefore, the logic goes, loading costs and increased profits on local service is appropriate.

The NATA study demonstrates that if Bell's costs are fully distributed, local service is in fact profitable, and that any subsidy which may exist would be more than offset by the intrastate revenue deficiencies for customer premise equipment and private line services.

However, Bell's own cost methodologies themselves cannot support the AT&T assertion of subsidized local service.

Attached to my testimony, as an Appendix, are charts entered as evidence in U.S. v. AT&T as part of the expert testimony of Dr. William Melody, an economist at Simon Fraser University in British Columbia.

Dr. Melody studied the application of Bell's so-called Embedded Direct Analysis of costs in 21 states. This is the standard Bell cost methodology.

The charts show that in 14 of the states, Bell's local exchange services did meet their direct costs and did make a contribution to common costs and access line costs -- this, according to Bell's own methods. (And, supporting the NATA findings, the Bell methodology shows terminal equipment and private lines to be unprofitable in most cases.)

In all cases, those access line costs were exaggerated. Astoundingly, Bell assigned 100 percent of non-traffic-sensitive plant to the intrastate jurisdiction -- despite the fact that AT&T's claim of subsidy depends upon assignment of 25 percent of those very costs to interstate operations!

In the six states in which local service was claimed not to be meeting its costs, Bell had the further audacity to assign all non-traffic-sensitive plant not only to intrastate, but also solely to local exchange service as a "direct cost."

These cases are marked on the charts by asterisks. Once that "direct assignment" is removed, none of the six states shows local service revenues to fall below direct costs -- even leaving in place the bogus 100 percent assignment of non-traffic-sensitive costs to intrastate.

To this evidence, one must add MCI's own work with Bell's cost allocations, in the Texas rate case mentioned above.

Here, Southwestern Bell followed the AT&T practice of assigning all non-traffic-sensitive costs to intrastate and further assigning all of those costs to local service. That is contrary to Bell's own claims of how these costs are actually allocated.

In addition, MCI began the process of challenging other assignments of "direct costs" to local service. We examined 30 out of hundreds of cost categories, and discovered many millions of dollars in costs assigned to "local service" which do not belong there. For example, although all of the revenues from customer premise equipment were retained under that line of business, a portion of the costs of maintaining that equipment was assigned to "local service."

Eventually, the cost allocation techniques, which are Bell's sole buttress for the claim that local rates need a subsidy, will fall of their own weight. They cannot stand the light of day.

Divestiture, however, will hasten that day. It will bring to an end Bell's ability to carry on this shell game. Local service revenues will be compared to local exchange costs which can no longer be manipulated, and falsely made to appear high.

Conclusion

Settlement of U.S. v. AT&T has been claimed, erroneously, to presage huge increases in the rates charged for local telephone service. This is based on the belief that Bell's internal version of "separations and settlements" -- the Division of Revenues process -- yields a net subsidy payment to the Bell Operating Companies out of interstate revenues, and that this "subsidy" accrues entirely to the benefit of local rates. The source of this subsidy is supposed to be the so-called Subscriber Plant Factor, or SPF, which over-allocates non-traffic-sensitive local exchange plant costs to Bell's interstate operations. With divestiture of the operating companies, it is assumed, AT&T will no longer be willing to pay the "subsidy."

There is substantial contrary evidence to this mythology. In any event, the forthcoming consent decree intervenes in internal Bell System financial relationships in a way that is positive from the viewpoint of local exchange ratepayers.

1. Because of its integrated ownership structure, AT&T is uniquely positioned to offset any SPF-related overpayments to the BOCs by underpaying them for other facilities and services.

   In point of fact, the Operating Companies are paid much less, through Division of Revenues, than independent telephone companies are paid under separations and settlements -- yet the BOCs presently also operate the least efficient part of Bell's long distance plant, with costs per circuit mile 600 percent of AT&T's Long Lines Department.

   After divestiture, the opportunities to undercompensate the BOCs will end, and AT&T itself must carry the entire burden of inefficient long distance plant.

2. As Assistant Attorney General William Baxter has stated, Bell can, and probably does, indirectly offset SPF by overcharging the BOCs for license contract payments and Western Electric equipment. With divestiture, such overcharges would cease, along with dividend and interest payments to the AT&T Treasury which amounted to $4.5 billion in 1980.

3. While there is no reason to believe that AT&T is in fact paying the alleged subsidy to its own companies, there is ample reason not to believe that any subsidy which may exist actually reaches local exchange rates to "keep them low."

   Recent studies demonstrate that Bell's local exchange services are profitable. By contrast, the terminal equipment and private line businesses are "losers," subsidized from other revenue sources.

   The amount of losses in these areas would more than totally absorb the entire "subsidy" amount claimed by Bell, leaving nothing for local rate relief.

   Divestiture would intercede here, as well. The BOCs' customers would be relieved of the burden of AT&T's subsidized private line and customer premise equipment businesses.

4. Divestiture would bring to an end AT&T's ability to load increased costs onto local exchange rates.

   Bell argues that because of competition for its long distance and equipment businesses, most of the price increases caused by inflation, increased profitability, increased debt service,

> and accelerated depreciation should be paid mostly by local exchange ratepayers -- the totally monopolized service.
>
> Clearly, these factors should affect Bell's other lines of business as well, and after divestiture, they would have to. Since AT&T will no longer own the local exchanges, they will not be able to "dump" the Bell System's increased costs on them. This would end the single greatest threat to local telephone rates.

It is necessary to add a final caveat.

Properly implemented, the decree should bring net benefits to customers of the Bell Operating Companies.

However, the judicial process must see to it that divestiture does, in fact, relieve the spun-off companies of the burdens I have mentioned.

What is AT&T's incentive? It is to divest as much of its inefficiency as possible. The incentives of the operating companies are largely complementary: to keep as much of the plant as possible, since they will be guaranteed a percentage rate of return on the investment remaining to them.

In that regard, the testimony of state public utilities commissioners before this body last week is disturbing. The state regulators seemed to be urging that the BOCs retain much of the plant which ought to remain with AT&T. They seem to be looking only at the "loss" of BOC revenues, without factoring in the loss, as well, of costs.

I sincerely hope NARUC is not urging that the BOCs retain inefficient plant in order to "enhance" separations payments, because that is probably a less-than-zero-sum game, and -- in any event -- one which cannot continue.

If this is what they are proposing, they would saddle the operating companies with money-losing businesses and the most burdensome elements of plant -- to the long-range detriment of consumers. Such actions would guarantee high local rates.

I do not think such views can prevail. If this settlement is properly done, we are on the verge of the beneficial and historic reform of a badly-abused industry.

APPENDIX

Plaintiff's Exhibits

INTRASTATE SERVICES PRICED BELOW DIRECT COST AND THEREFORE REQUIRING A SUBSIDY1/

X = requires a subsidy

		MONOPOLY	COMPETITIVE		
STATE	YEAR	EXCHANGE	INTRASTATE PRIVATE LINE	RESIDENTIAL VERTICAL [EQUIPMENT]	BUSINESS VERTICAL [EQUIPMENT]
California	1979			-----x2/------	
Colorado	1979		X	X	X
District of Co.	1974		X		
Florida	1978		X	X	X
Georgia	1979	*3/	X		
Kansas	1977	*	X		
Massachusetts	1979		X	X	X
Minnesota	1976				X
Montana	1977	*	X	-----x2/------	
New York	1978		X		
North Carolina	1979	*	X		
Oregon	1979		X		X
Pennsylvania	1978		X	X	X
South Carolina	1979	*	X		
South Dakota	1978		X		X
Tennessee	1979	*	X		
Texas	1979		X		X
Utah	1979		X	X	X
Vermont	1979		X	X	X
Virginia	1978		X		
Washington	1979		X		X

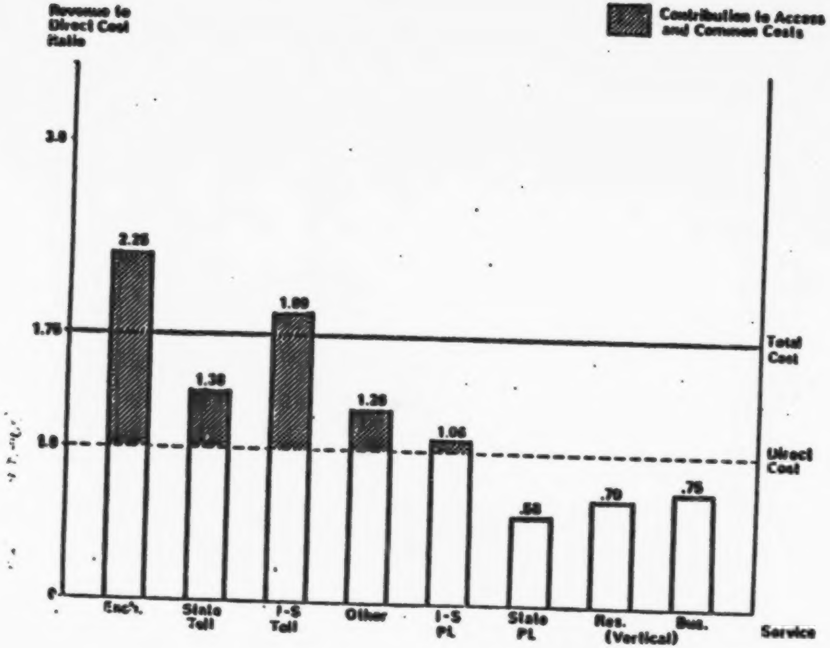
1/ The above table summarizes the attached bar charts, which are plaintiff's exhibits no. 2949, 4381-4400 in the Government's antitrust suit against AT&T, U.S. v. AT&T, Civ. No. 74-1698 (D.D.C.); the bar charts were submitted in connection with the testimony of Dr. William H. Melody, and are based on Embedded Direct Analysis (EDA) cost studies prepared by AT&T Operating Companies.

2/ For combined vertical services, business and residential.

3/ These jurisdictions (identified by an asterisk) appeared to show a revenue deficiency in local service (relative to direct costs) because the Bell Companies included non-traffic-sensitive "access line" costs as direct costs of local service, whereas in other jurisdictions such costs were shown separately as access line costs.

27-1P

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Vermont, 1979



RED 999 - 1381

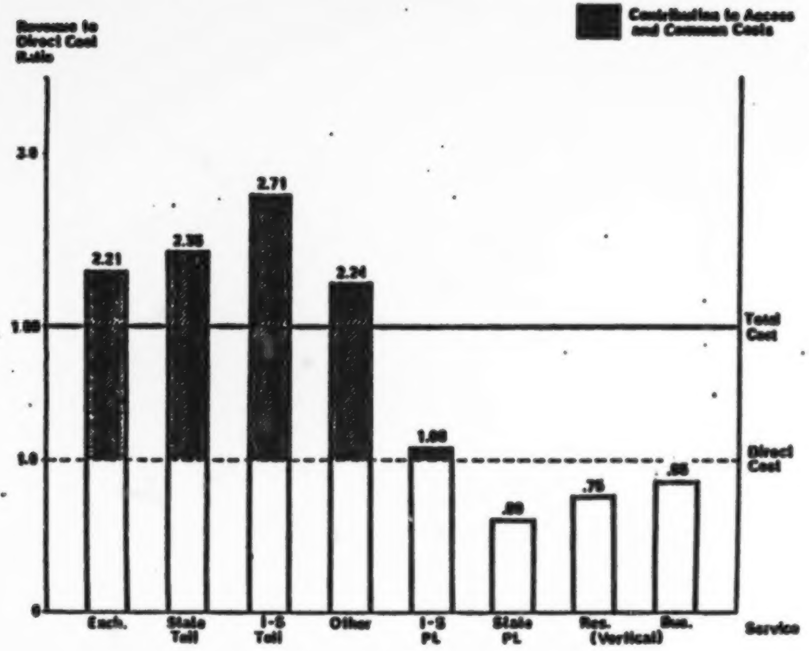
PLAINTIFF'S EXHIBIT 4381

CA 74-1698

431

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Colorado, 1970



RED 999-1387

PLAINTIFF'S EXHIBIT 4387

CA 74-1698

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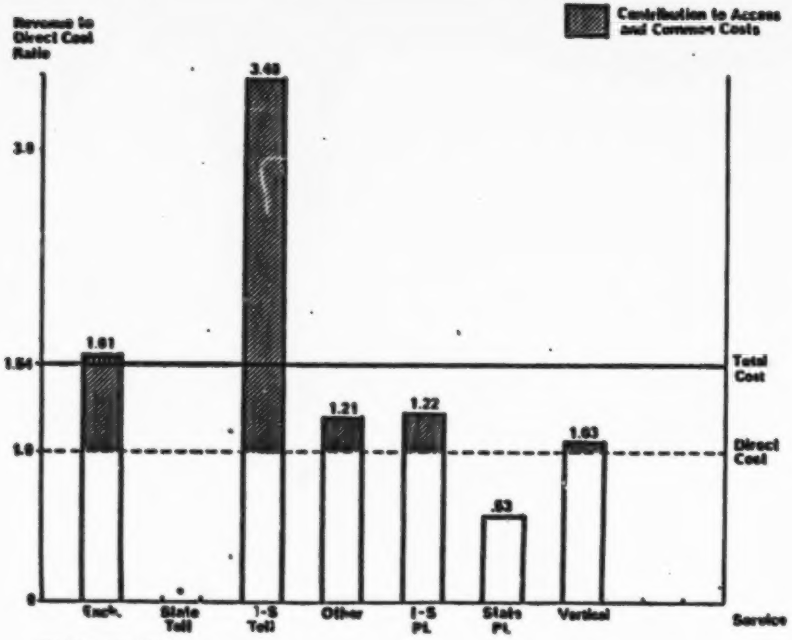
29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
District of Columbia, 1974



*No Intrastate Total

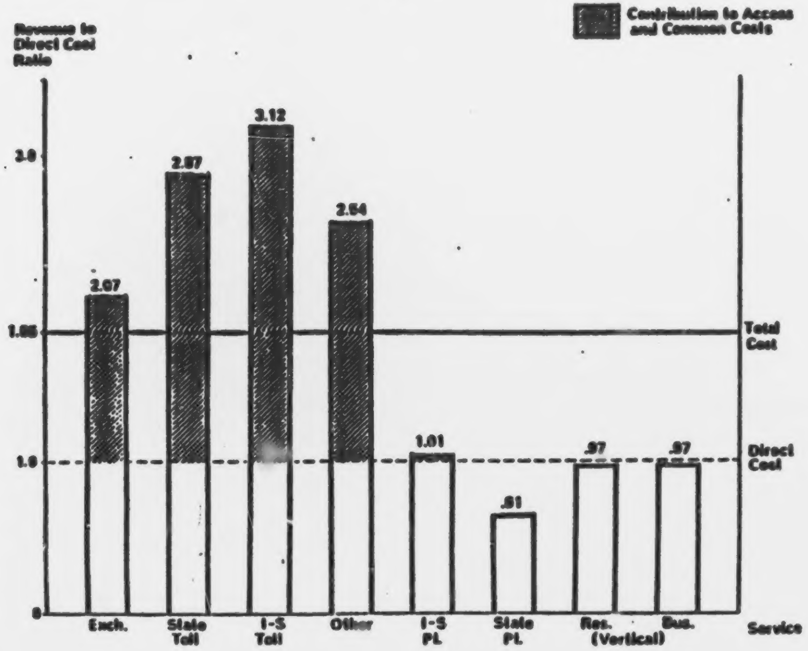
RED 999-1300

PLAINTIFF'S EXHIBIT 4400

CA 74-1698

29=TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Florida, 1978



RED 999-1294

434

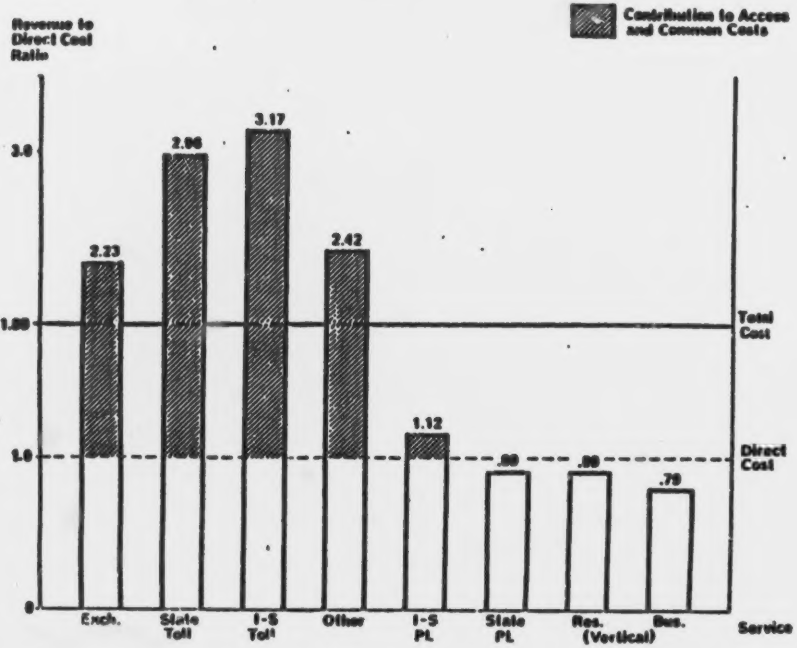
PLAINTIFF'S EXHIBIT 4394

CA 74-1698

434

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Utah, 1979



RED 999-128F

435

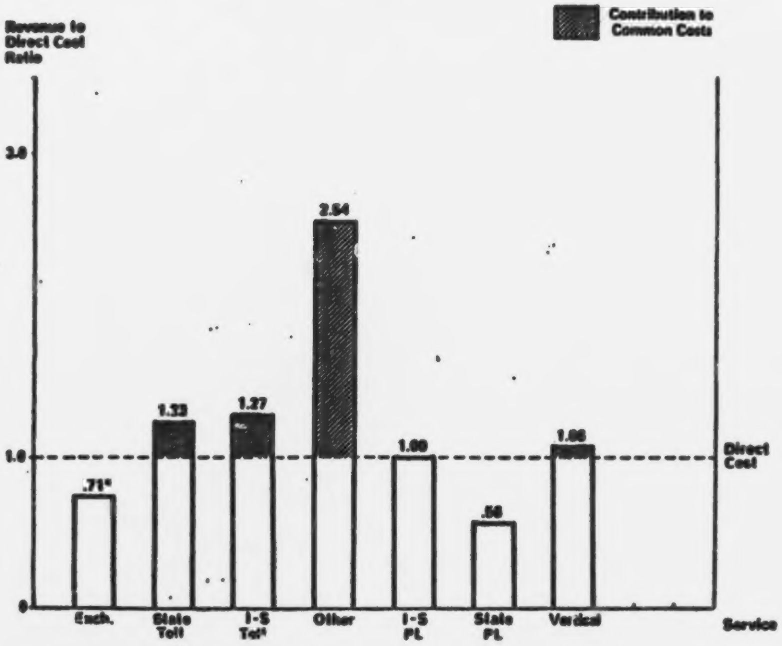
PLAINTIFF'S EXHIBIT 438E

CA 74-1698

435

29=TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Kansas, 1977



*Access charges arbitrarily allocated to exchange

RED 999-1297

436

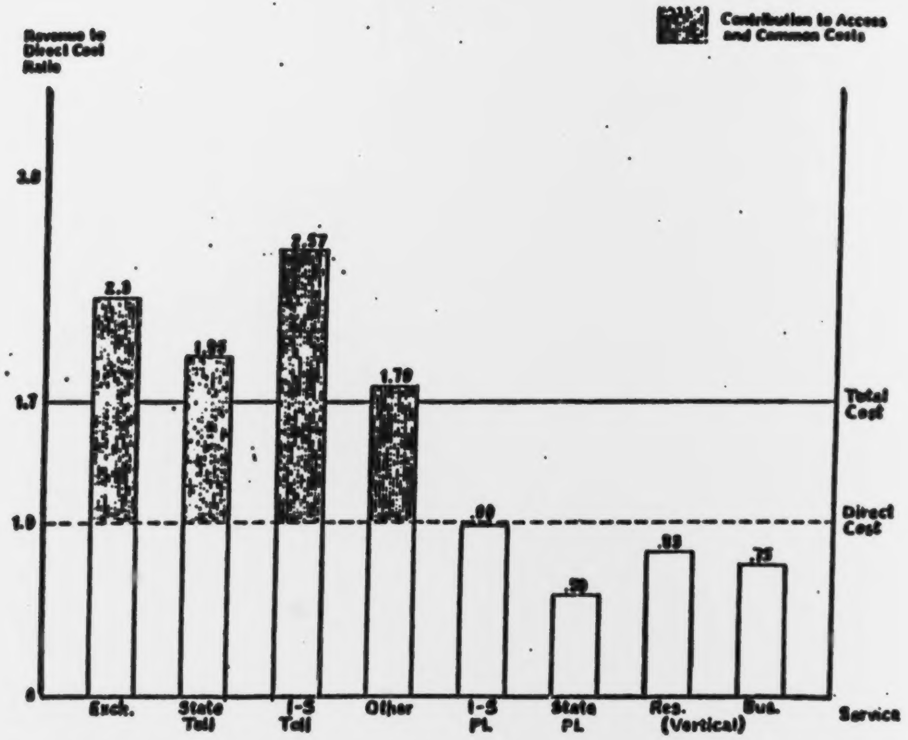
PLAINTIFF'S EXHIBIT 4397

CA 74-1698

436

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Massachusetts, 1979



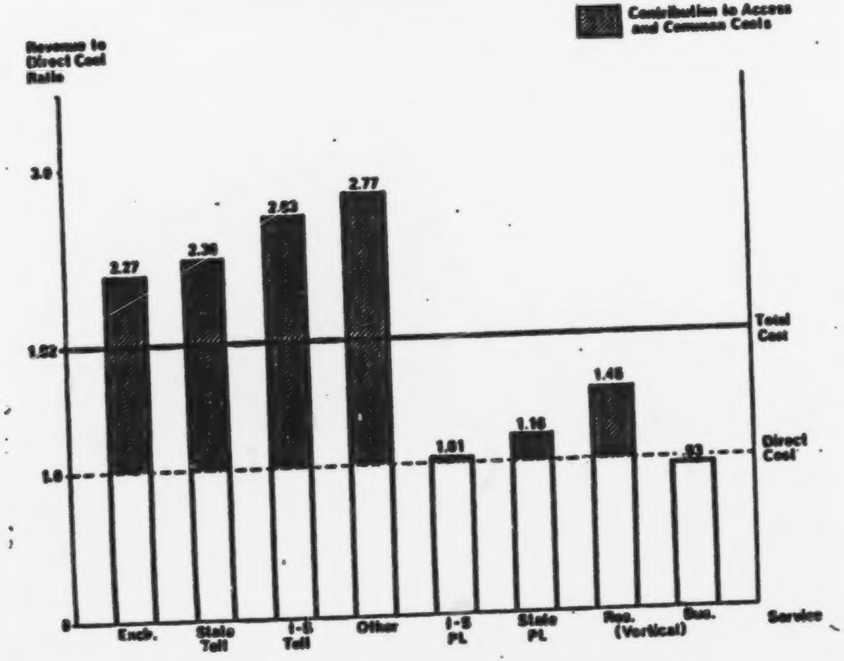
RED 999-1431

PLAINTIFF'S EXHIBIT 29 49

CA 74-1698

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Minnesota, 1976



RED 999-1299

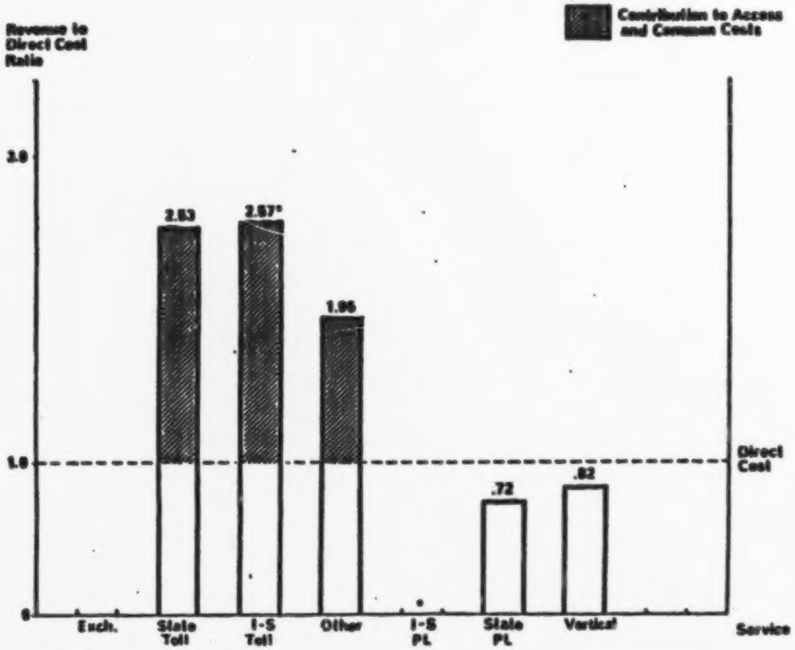
PLAINTIFF'S EXHIBIT 4399

CA 74-1698

RED 999-1269

439

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
California, 1979



* Total Interstate

PLAINTIFF'S EXHIBIT 4389

CA 74-1698

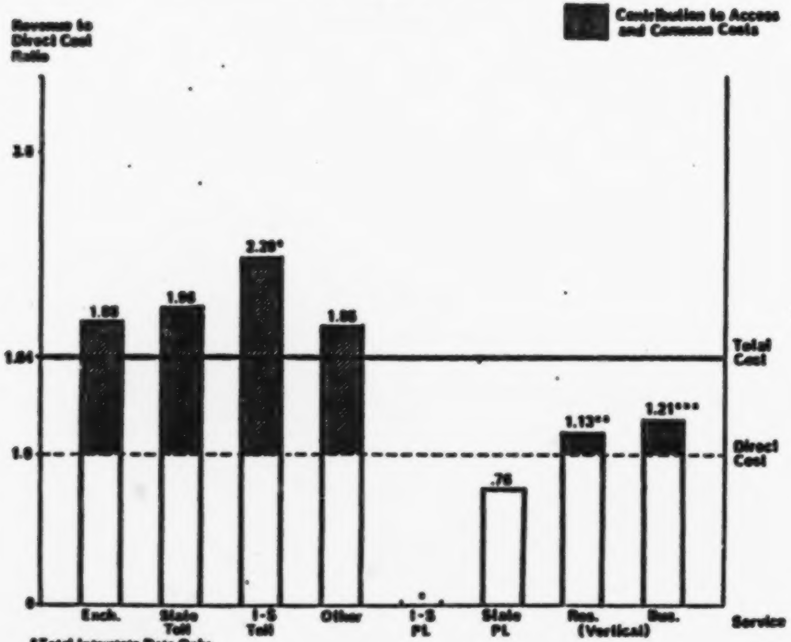
439

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis

Ratios of Revenue to Direct Cost, by Service

New York, 1978



*Total Interstate Data Only
** Terminal Designations
*** Supplementary Services

440

RED 999-1296

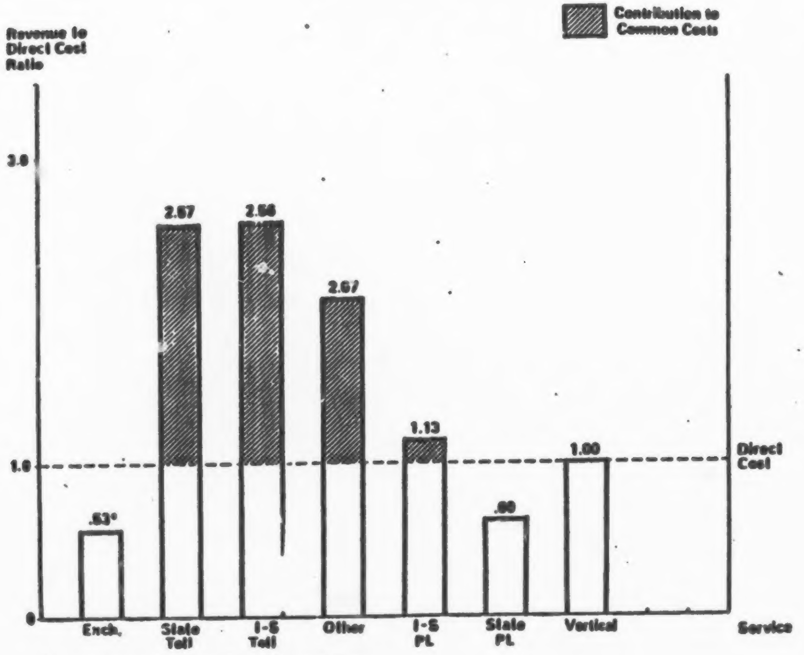
440

PLAINTIFF'S EXHIBIT 4396

CA 74.1698

24-11

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
North Carolina, 1979



*Access charges arbitrarily allocated to exchange

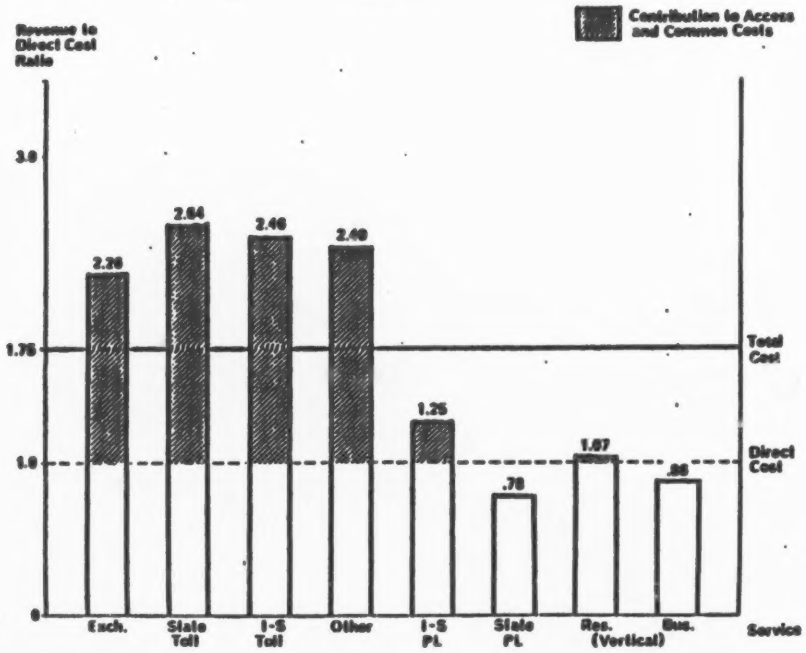
RED 999-1263

PLAINTIFF'S EXHIBIT 4383

CA 74-1698

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Oregon, 1979



HH2

RED 999-1290

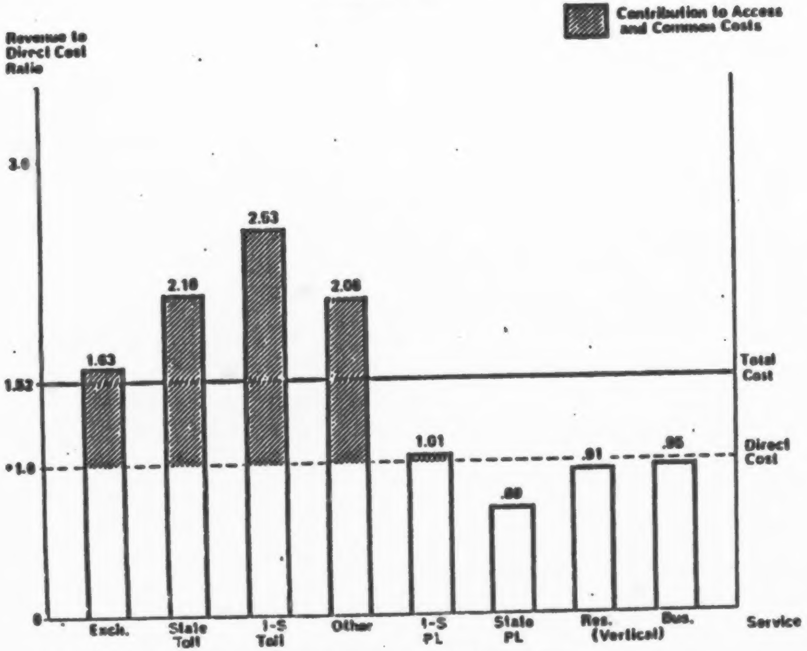
PLAINTIFF'S EXHIBIT 4390

CA 74-1698

29-TP

RED 999-1292

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Pennsylvania, 1978



* Common Costs allocated on basis of Gross Investment included in Direct Costs

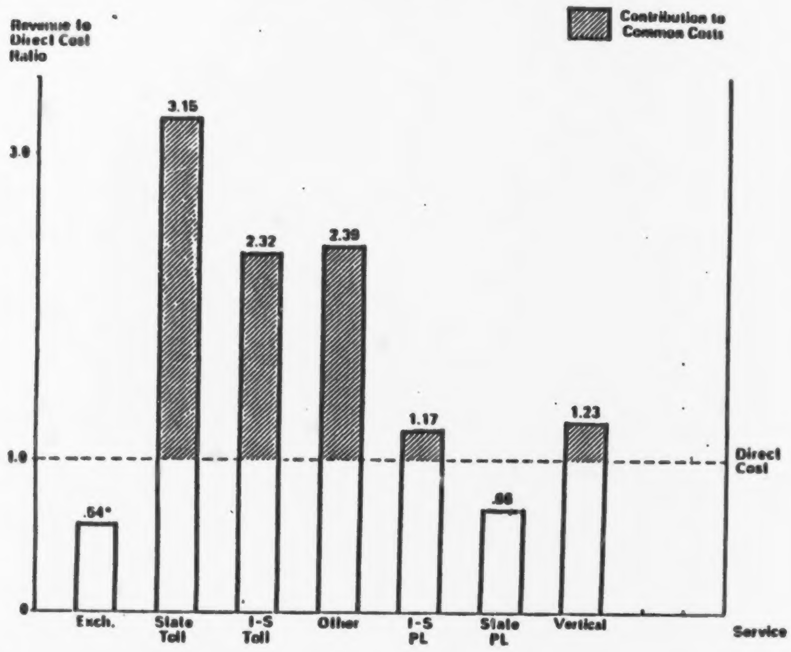
PLAINTIFF'S EXHIBIT 4392

CA 74-1698

443

24-11

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
South Carolina, 1979



*Access charges arbitrarily allocated to exchange

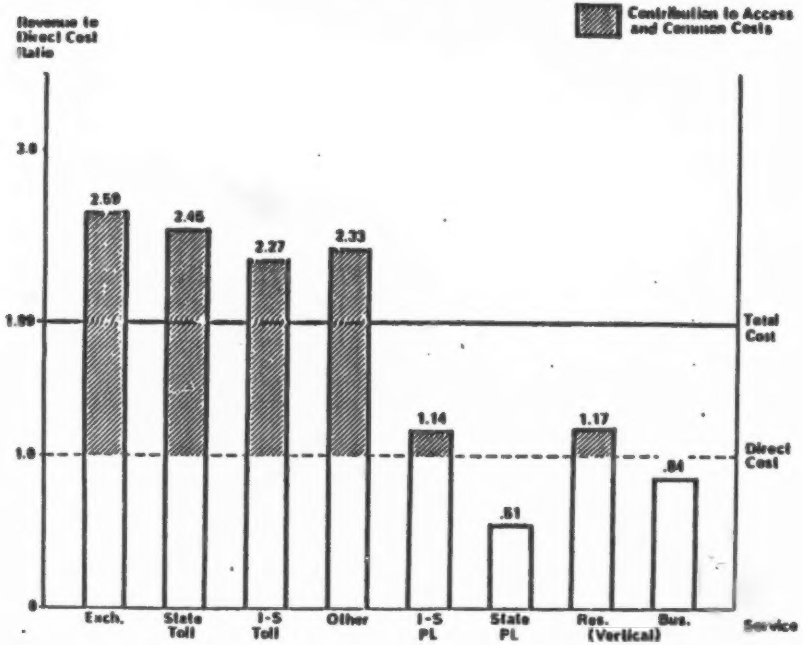
RED 999-1054

PLAINTIFF'S EXHIBIT 4384

CA 74-1696

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of *Revenue* to Direct Cost, by Service
South Dakota, 1978



RED 999-1295

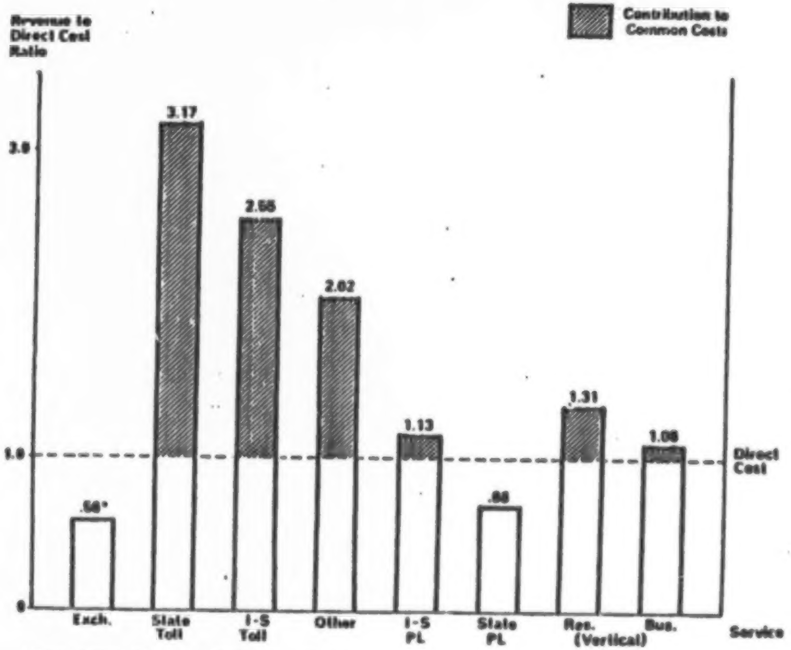
PLAINTIFF'S EXHIBIT 4395

CA 74-1698

445

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Tennessee, 1979



*Access charges arbitrarily allocated to exchange

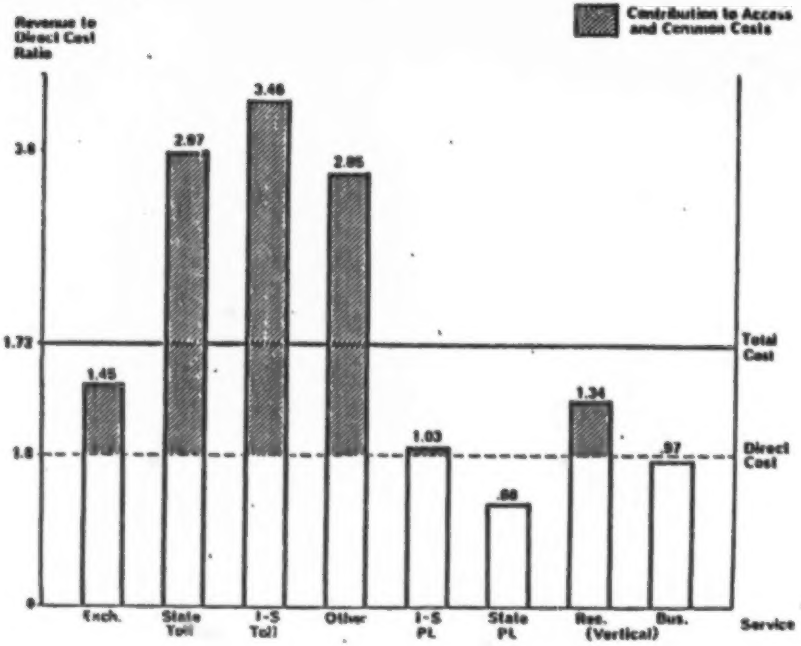
PLAINTIFF'S EXHIBIT 4385

CA 74-1698

446

29-TP

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Texas, 1979



PED 999-12EG

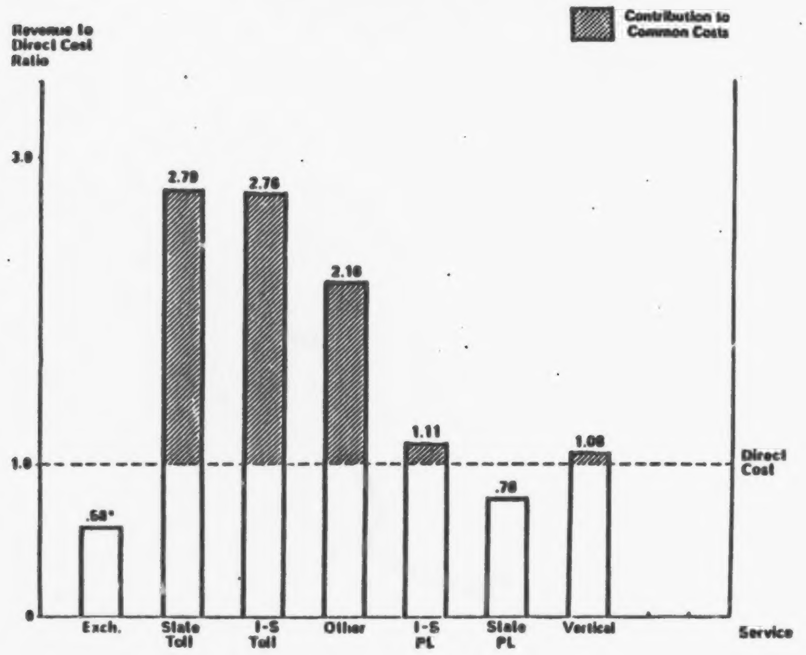
PLAINTIFF'S EXHIBIT 4386

CA 74-1698

447

27-11

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Georgia, 1979



*Access charges arbitrarily allocated to exchange

REN 999-12ED

PLAINTIFF'S EXHIBIT 4382

CA 74-1698

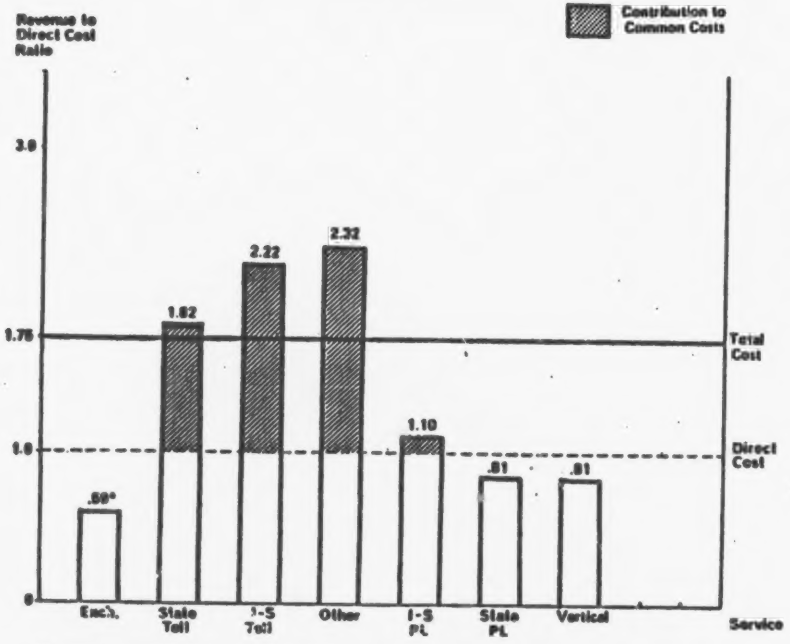
448

29=TP

AT&T Operating Company Comparison
Embedded Direct Analysis

Ratios of Revenue to Direct Cost, by Service

Montana, 1977



*Access charges arbitrarily allocated to exchange

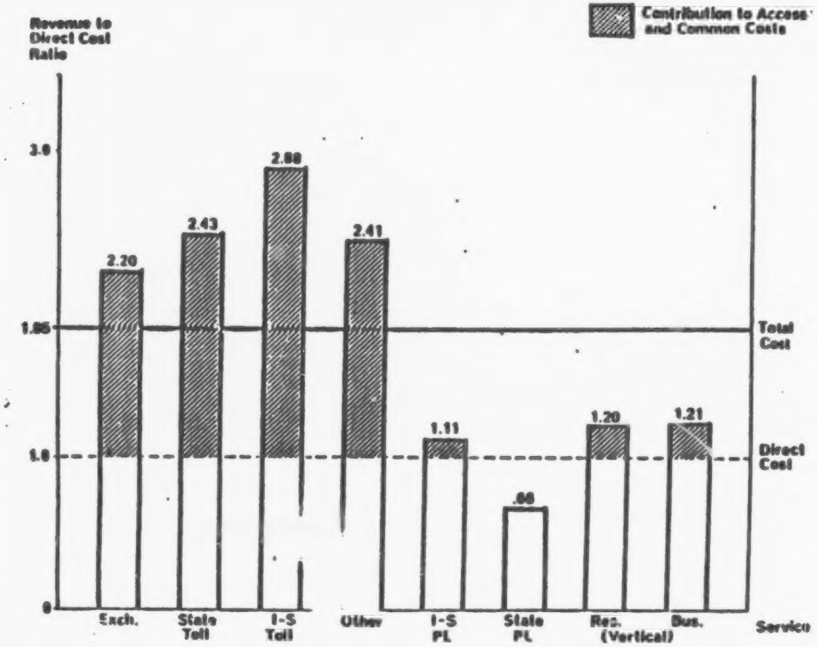
RED 999-1398

PLAINTIFF'S EXHIBIT 43.98

CA 74-1698

24-11

AT&T Operating Company Comparison
Embedded Direct Analysis
Ratios of Revenue to Direct Cost, by Service
Virginia, 1978



RED 999-1293

450

PLAINTIFF'S EXHIBIT 4393

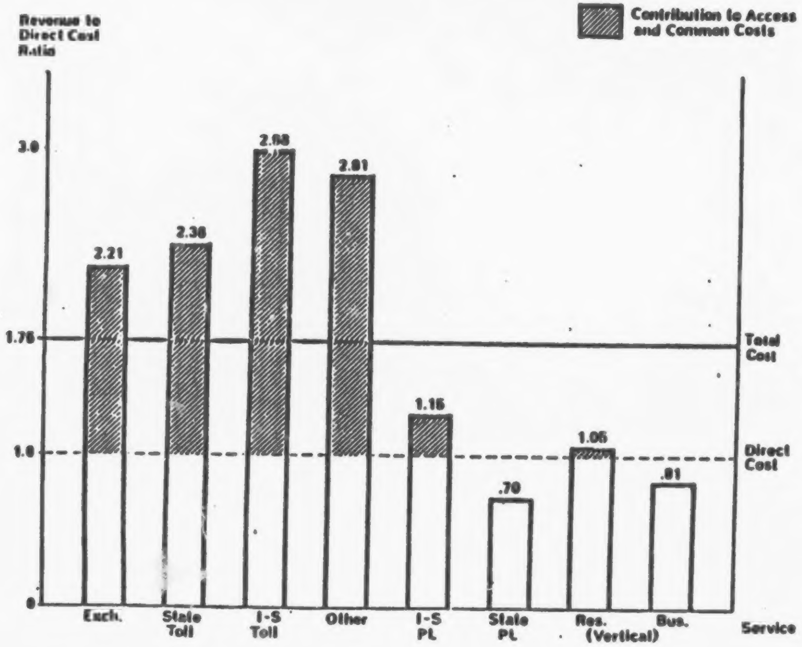
CA 74-1698

450

AT&T Operating Company Comparison
Embedded Direct Analysis

Ratios of Revenue to Direct Cost, by Service

Washington, 1979



RED 999-1297

PLAINTIFF'S EXHIBIT 4391

CA 74-1698

Mr. **Wirth**. Thank you, Mr. McGowan.
Mr. Lafer.

STATEMENT OF FRED S. LAFER

Mr. **Lafer**. Thank you, Mr. Chairman and members of the subcommittee. I appear before you today as vice chairman of the Association of Data Processing Service Organizations, known as ADAPSO, and including within its membership approximately 500 data processing companies. I am also senior vice president of Automatic Data Processing.

I would like to tell you a little bit about ADAPSO and what its companies do so we can put into perspective our concern about the settlement and prospective legislation. We are the principal trade association of the data processing industry. Our members provide America and the worldwide public with a broad spectrum of services, including local batch data processing software design and support, as well as remote access services.

Remote access is really the thing that we are talking about, because those are the computing services, as the name implies, which enable geographically dispersed users to access the computers of our members and others.

The link between the customer and the computer is achieved through the use of common carrier communications services. Communication facilities are used to deliver data processing services to clients in much the same way that the mail or trucks or other means of transport are used to deliver physical goods to customers geographically distant from sources of supply. Unlike vendors and other industries, however, remote access data processors and information service providers are captives, totally dependent upon a single means of transport to deliver their services to the public, namely common carrier communications facilities.

The terms of the proposed settlement are many. However, three are of special interest, and I would like to take a moment with you to discuss them. The first and certainly the most widely publicized provision of the settlement is the divestiture requirement into 22 or 21 or several local Bell operating companies separated from the parent. In our view, the divestiture of these BOC's will prove to be a major step in the development of a more competitive telecommunications marketplace. By eliminating A.T. & T.'s control over most local distribution facilities and by imposing upon the divested BOC's the obligation to provide equal and nondiscriminatory access, the proposed settlement should indeed foster the evolution of meaningful competition in the provision of intercity transmission services.

As you know, notwithstanding some assertions to the contrary, such competition plainly does not exist today. In the absence of legislation, however, the vigorous competition envisioned by the settlement may be slow to materialize. As a result of the restructuring of the Bell System contemplated by the settlement, the charges leveled by the divested BOC's for exchange and information access service, as well as the terms and conditions of A.T. & T.'s intrastate interexchange service, may well be beyond the limited jurisdiction of the Federal Communications Commission.

Authority over such offerings will reside in the States, and faced with the prospect of dealing with scores of State public utility commissions intent upon maintaining affordable local rates as they interpret them, potential competitors in the provision of interexchange transmission service may decline to enter the marketplace. Similarly, vendors of computer services wishing to access local exchanges with their data processing networks may restrict their operations rather than deal with 51 different commissions and 51 disparate information access provisions.

To assure that the goals of the proposed settlement are indeed achieved, we deeply believe that the Communications Act must be amended. Legislation must expressly confirm the Commission's exclusive jurisdiction over the terms and conditions for exchange and information access, as well as for A.T. & T.'s interexchange transmission services.

The second aspect of the proposed settlement of interest to ADAPSO is that which confirms A.T. & T.'s dominance in the provision of interexchange transmission service. Although the settlement dramatically restructures the BOC's, it leaves intact and simplifies A.T. & T.'s control over the Nation's interexchange communications network. A.T. & T.'s provision of intercity service, coupled with the transfer of all customer-premises equipment to A.T. & T., will provide A.T. & T. with virtually guaranteed revenues and an enormous customer base. Although the proposal settlement will deprive A.T. & T. of legal control, although not de facto control, over local distribution facilities, A.T. & T. will nonetheless remain the dominant carrier in every sense of the term.

And this brings me to the third facet of the proposed settlement of concern to ADAPSO. Under the terms of the parties' agreement, A.T. & T. will be relieved of the constraints of the 1956 Western Electric consent decree which limit A.T. & T. to the provision of regulated communications services. Freed of these restrictions, A.T. & T. will be able to participate in such competitive—and communications-dependent—markets as the computer and information services industry.

Once having entered such an unregulated market, A.T. & T. would have both the incentive and the opportunity to use its monopoly power and resources, and its control over the intercity communications network, to thwart competition. As both a competitor of, and a supplier of service to, the computer services industry, A.T. & T. would be uniquely situated to engage in tying and other forms of unfair competition. Nothing in the proposed settlement would impede such conduct.

As the predominant provider of interexchange service and customer-premises equipment, A.T. & T. could easily misuse privileged information about its customers and its customers' customers. Similarly, A.T. & T. could manipulate the quality, availability, restoration, and maintenance of service for anticompetitive ends. It also has control over advance information and the structure of a system. If data processing operations would be in a position to capitalize on advanced knowledge of proposed changes in the network. In short, A.T. & T. could use its historic government-conferred franchise to support its competitive endeavors in unregulated markets.

None of this is to say that the settlement is bad or that A.T. & T. should not be permitted to enter unregulated markets. My purpose in focusing upon A.T. & T.'s dominance and its newfound freedom is not to condemn the settlement or to exclude A.T. & T. from competitive markets. Rather, my goal has been to highlight the continuing need for stong competitive safeguards whenever A.T. & T. engages in unregulated activities. Although the proposed settlement gives A.T. & T. unrestricted entry into new markets for the first time since 1956, it inexplicably fails to address the manner in which that entry is to be accomplished.

Not too many years ago there was no industry known as the data processing services industry. Today that industry boasts of over 4,300 firms, 400,000 new jobs, and revenues of approximately $15 billion growing at the rate of 20 percent per year. This happened in an environment of free competition without a regulated company in the midst of it. My purpose here today is primarily to implore you to the extent that I can to maintain the environment which permitted the growth of such an industry, creating jobs and opportunities and advancement in this country. And if the settlement is not to have an adverse impact on unregulated markets and the public which they serve, it must be modified by the parties. If it is not modified, then legislation is absolutely essential, in our view. Only a structural approach that completely separates A.T. & T.'s regulated and unregulated activities will limit the opportunities for abuse. Absent such safeguards, A.T. & T. will be able to wield its monopoly power and resources to the detriment of competition in unregulated markets and to the disadvantage of users of its regulated services. Clearly, this is not a result with which the Department of Justice or the Congress should be satisfied.

In closing, I wish to stress that the shortcomings of the proposed settlement are ones of omission and not commission, as we see them. Although the settlement can and should be modified to assure that A.T. & T.'s entry into unregulated markets is accompanied by strong structural safeguards, only legislation can extend the Commission's jurisdiction over access charges and all interexchange communications. In ADAPSO's view, the preferable course would be for legislation to address both issues.

Thank you.

Mr. WIRTH. Thank you.

Mr. Forster.

STATEMENT OF WILLIAM H. FORSTER

Mr. FORSTER. Thank you, Mr. Chairman.

The objective or one of the major objectives of the settlement is to increase competition in equipment and service markets. I would like to focus specifically on the network equipment manufacturers industry. The cancellation of the Bell operating company and WECO—those steps are beneficial, but more action is necessary to insure a truly competitive market.

There are several other issues that affect equipment competition, patents and licensing. The BTL fundamental patents are absolutely necessary in the whole electronics industry. Large companies have cross licenses, so as long as those agreements run, it does not make much difference, but small companies might have a significant problem if the patenting issue is not handled appropriately.

I would like to ask that the backup material from remarks I made to the Judiciary Committee of the Senate on June 17 be included.

Mr. WIRTH. Without objection.

Mr. FORSTER. As an interim measure, we think it is necessary to have quotas. That is the bottom line of this talk. And a quota, another way of looking at that is to call it a limitation. The limitation should be on Western Electric or on anyone, including ITT, and the limitation should be by product family narrow enough to insure that the objectives of competition in the market are met. H.R. 5158 with its 30-percent quota at the end of 10 years equaling a 70-percent limitation made a lot of sense. We do not like quotas because we believe in open and competitive markets, but nobody has found a better way of accomplishing the opening of the market considering the present structure.

The Department of Justice in its pretrial brief on December 10, 1980 said in essence that even after divestiture because of possible institutional loyalties it might be necessary to have interim quotas in order to open up the network equipment market. The consent decree, of course, requires that purchasing be nondiscriminatory, and incidentally, that is for the BOC's. We think it should also apply to long lines, including long lines with the intrastate toll service, but it is a good question as to whether the market will really be open just because the settlement says that the procurement is to be nondiscriminatory.

The best example we have of what happens when you have a really open market, one perceived to be open by the potential participants, is the PABX market. My colleague on the left may speak to this. I would say that 13 years after the *Carterphone* decision in 1968 the U.S. PABX's are the best in the world, and we can compete against the Japanese, and, also, the general trade wins about half the orders in competition with the BOC's providing Western Electric products. So it shows what a competitive industry really can do.

It is also interesting to note that whereas it is the conventional wisdom to look to the Bell System as the technological leader, the businessmen of my PABX's look to the general trade for leadership and product innovation. There are major differences between the end-user products and network products, and we have to deal with the fact that the network products are not bought by thousands of different decisionmaking centers. They are bought by engineering professionals trained to think and buy Western Electric. So divestiture could lead to an open competitive market, but also within the long time that it is going to take, WECO has plenty of opportunity to strengthen its position with the operating companies and to expand its marketing into the independent market and into the international market. So, that unless the market is opened quite quickly, it might never become more competitive.

There is talk, of course, of centralizing a BOC purchasing function, and that has severe dangers for a competitive market because large organizations tend to change their ways more slowly than small, and monopolies are risky in a business which requires large front-end investments in research and development. So the BOC's can surely develop an independent-minded procurement function, but how long will it take?

There is another problem. The result of the settlement could very well be a reduction in regulatory pressure for fair and equal treatment in procurement, and certainly settlement of the antitrust suit would tend to reduce or make the environment for private antitrust suits a little less open.

Now, let us have a word about export. That was taken up by the previous panel, and I am sorry that I could not raise my hand and say we volunteer to sell the Bell System into export. There is a school of thought that says the United States would be best served by having one strong, unfettered Western Electric, but with your remarks I do not have to say more. We agree a domestic market with competition produces lower costs and a more rapid introduction of new products, product innovation. Our experience in ITT, we have 28 national telecommunications manufacturing companies around the world. We never have a monopoly. Typically, we are second or third largest, sometimes fourth, but I can assure you that domestic competition makes our local manufacturing associates shape up a lot, and once they do that, then the export—typically we export between 18 and 20 percent of our telecommunications products around the world. In 1980, in the United States we exported 13 percent and Western Electric about 2 percent. In conclusion, the best way to help Western Electric is to give them local competition, and the answer to that is limitations to make that happen.

And the question of size—people will raise that question. Western Electric is twice as large as the total of ITT's 28 national companies, and I underline national because it is hard to control them scattered all over the world. They are four times as large as Siemens or Erickson. Number 3 and number 4, much larger than any of the Japanese companies. With a 70-percent limitation, the Bell market would be three times larger than their largest single competitor. So, the Bell market does not have to all be WECO for WECO to be strong.

Depending on the theory that the settlement will open up the market is, I think, a little dangerous, considering the experience of certainly the last 5 years and perhaps the last 16 years in the FCC's work in this field. Therefore, we ask for procurement limitations as a basic part of industry restructuring. We are very much in favor of legislation. As somebody said earlier, the sooner the better. Maybe you said it. Give us a chance to do the same kind of a job——

Mr. WIRTH. That would not have been me.

Mr. FORSTER. Well, give us a chance to do in network products what the industry has shown it can do in PABC's.

Thank you.

[Testimony resumes on p. 479.]

[Mr. Forster's prepared statement follows:]

TESTIMONY OF WILLIAM H. FORSTER
VICE PRESIDENT,
INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION
NEW YORK, NEW YORK

BEFORE THE HOUSE SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION & FINANCE
POTENTIAL IMPACT OF PROPOSED AT&T DIVESTITURE
ON COMPETITION IN
TELECOMMUNICATIONS EQUIPMENT MANUFACTURING

FEBRUARY 9, 1982

I am William H. Forster, a Vice President of ITT, and Product Group Manager for our Telecommunications & Electronics business sector worldwide. I have been with ITT for 16 years. Until 1976, I was Vice President and Technical Director of ITT Europe with the responsibility for supervising the research and product development of our telecommunications companies in 15 countries. Since 1976, I have been headquartered in New York with a worldwide responsibility as Product Group Manager. I am familiar with the products and markets and with the relationships which exist between suppliers of telecommunications equipment and their telecommunications operating company customers.

The proposed settlement between the Department of Justice and AT&T has as its objective the increasing of competition in several areas of telecommunications products and network services. Divestiture of the BOCs and the cancellation of the WECO/BOC supply contracts are beneficial, but more actions are necessary if a truly competitive market is to be developed.

I would like to focus on telecommunications network products -- switching and transmission equipment and related products, including cables, which are procured by telephone operating companies -- both exchange area and intercity carriers. There are many other major issues involving customer premises equipment, the ownership and licensing of current and future patents, and organizational structures for planning networks and establishing functional standards. These affect competition in a major way and should be the subject of expert testimony.

Last June 17th, I had the privilege of presenting testimony before the Senate Judiciary Committee regarding Monopolization and Competition in Telecommunications. With your permission, I would like to make my remarks and the attached source material paper on Bell System procurement practices a part of this record.

Since last June two events related to competition in network products stand out:

First, the introduction of H.R. 5158, which among other beneficial features, recognizes the advantages of competition in the manufacture and sale of telecommunications network products and proposes a quota system by product families. The percentage of equipment requirements to be procured by the BOCs from sources outside of Western Electric would build up to 30 percent over a period of ten years and the market would then be reevaluated by the FCC to determine whether or not the equipment market had become sufficiently competitive to warrant abolishing or modifying the quotas. Looking at this another way -- the bill proposes a limitation on the amount of equipment that the Bell System could buy from WECO. A very important part of the concept was that the limitation would be applied by product family. The FCC would be required to define the categories as narrowly as necessary to ensure the intent of opening the market for product families including central office switching and digital multiplex equipment.

I think it is fair to say that the telecommunications equipment manufacturing industry of the United States considers this proposal appropriate. None of us like quotas because of our belief in an open and competitive market system, and also because of the difficulty of managing them; but, in years of trying, no one has found any other way to accomplish the objective of developing a competitive market for telecommunications network equipment.

The concept of quotas, or limitations, even after divestiture was encouraged by the DOJ in its pre-trial brief dated Dec. 10, 1980: "Over the short run, there is a strong possibility that the Bell System will continue to provide a captive market for Western equipment because of residual institutional loyalty, inertia, and long-term reliance on Western as a purchasing agent. Accordingly, it may be appropriate to require, as an interim measure, that the Bell operating companies and AT&T satisfy a certain amount of their equipment requirements from non-Western sources for a period of time. While quotas are no substitute for competition and may induce certain inefficiencies, we believe that the long term benefits of immediately opening the Bell market to alternative supply could outweigh any temporary inefficiencies." (Emphasis added)

Second, the announcement of the proposed settlement on January 8th changed the whole environment. The settlement requires that the BOCs (but not Long Lines) purchase their equipment on a non-discriminatory basis. In principal the ties between WECO and the BOCs are declared broken; transactions are to be arms-length. The settlement is silent with respect to equipment procurement by Long Lines. In our judgement the general trade should have equal opportunity with WECO in this market, too.

In spite of the proposed legal requirements, there is still the question: Under the proposed divestiture, will the market become more or less open and competitive than it is today? This depends primarily on whether potential competitors perceive the market to be open which is essential if they are to take the risk of investing human and financial resources to develop the products, build the manufacturing facilities and set up the marketing organization.

Let's look at an example which at the time, appeared to be an opportunity for potential competition. You will recall that in 1968, the FCC's Carterphone decision first authorized the connection of other-than-telephone company-provided equipment to the telephone networks. The major product involved was the PABX -- the office switchboard. Prior to 1968, the needs of the end-users had been served primarily by WECO and GTE -- and the products were not competitive by world standards. This new market opportunity was served initially by importing crossbar PABXs from Europe and Japan -- because of their additional operating features.

By 1975 -- seven years later -- several new U.S. manufacturers had developed electronic products which were demonstrably competitive in world markets and, as a side benefit, the Bell Laboratories had put on a crash program to develop their electronic PABX. It took 12 years, until 1980, before the general trade was winning 50 percent of the orders for new or replacement PABXs in competition with BOCs offering WECO products. U.S. manufacturers are now exporting products all over the world and several U.S. designs have been adapted to European PTT requirements.

There is an interesting sidelight concerning basic technology and the time required to incorporate it into products. It is generally agreed that the Bell Laboratories are a valuable national resource and have been responsible for major innovation in technology. It is easy to assume that leadership in basic technology flows over into leadership in in applying the technology to products in production. This generalization is not true. The business end-users who buy the PABXs from interconnect suppliers do not consider Bell the product leader. On the contrary, they look to the competitive industry. Today the PABX market is unarguably competitive.

The markets for PABX and for network products are very different. The businessman who buys a PABX is not a telecommunications engineer. He makes his decision on the basis of features which improve the efficiency of his operation, on price, and on the reputation of the vendor. This market is made up of thousands of decision-making centers.

Network products for BOCs are purchased by a small number of telecommunications professionals who have been trained to think that WECO makes the best, most cost-effective equipment, specifically designed for the needs of the BOCs; therefore, WECO products must be the best. One cannot expect this mind-set to change rapidly.

Divestiture creates a fundamental climate which can lead to a competitive market but it will take many, many years. We think a limitation on purchases from any single supplier must be imposed from the outset so that the market becomes open quickly. If this does not happen, the end result could be a decrease in competition.

The cost of developing a PABX can run up to $10M. The comparative cost for a family of central office switches is at least ten times larger -- from $60M to $200M or more. How many companies can be expected to make a commitment of this magnitude without a realistic market opportunity?

There has been no announcement yet as to how AT&T would propose to organize the divested BOCs. The settlement provides the option of establishing centralized service functions. Experience says that the larger the organizational entity, the more likely it is to maintain its present procurement practices and relationships. In addition, a monopsony inherently increases the risks to a supplier's front-end investment.

BOC's and the independent telephone companies will continue to need industry standards for the network and for major equipment blocks. Nevertheless, competition will tend to be greater if there are many centers for purchase decisions rather than a single, centralized purchasing organization.

Developing independent procurement organizations with the skill to manage competitive bidding is a formidable task, but in time the BOCs should be able to do it. The normal commercial forces would then be expected to lead to multiple sources of supply. The question is: How long will that take? Under the proposed settlement, it may never occur.

For years AT&T claimed that the market for network equipment was open but history shows that it is not open and has been difficult to open. In 1977, at the conclusion of an investigation which had lasted more than 11 years, the FCC ordered the BOCs to deal with the general trade on a "fair and equal" basis, to deal with WECO on an "arms-length" basis, and directed AT&T to establish a non-discriminatory procurement organization. Now, five year later, this still has not happened, as is illustrated by the widespread sense of frustration among general trade suppliers and the large number of procurement-related law suits. Regulatory pressure from both the FCC and some state PUCs has been essentially unsuccessful in changing WECO/BOC procurement relationships.

Nevertheless, the settlement of the Justice Department's antitrust suit suggests that we might expect complete cessation of these pressures. After all, the legal status of the operating companies and WECO will be "arms-length." Similarly, the possibilities for legal remedies, such as private antitrust suits, will be reduced, because, again, relationships will be "arms-length" by definition.

The performance of the general trade in the PABX field demonstrates technical and management competence in a clearly open market. We can be competitive in network products but we are going to need assistance during an interim period in order to justify the investment risk. Limiting the amount of each product family which could be purchased from any supplier (including WECO) would be a sound approach. We can't wait the 12 years it is required for general trade PABX's to reach 50% marketshare. A four to five year period would be reasonable.

There may be those who think the U.S. would be best off with a single, strong telecommunications equipment manufacturer, but this would clearly be contrary to the philosophy of H.R. 5158 and the antitrust laws which make the assumption that competition serves the public interest in the domestic market by motivating companies to reduce costs and to innovate. This is important because these capabilities in turn lead to competitiveness in world markets.

ITT manufactures telecommunications equipment in 28 countries. Nowhere do we have a monopoly position. Usually we are the second or third largest supplier in those markets. As a member of corporate management, I can assure you that domestic competitors improve the performance of our associated companies in their home markets.

If one examines the export markets, two factors are crucial to success:

1. The management of the exporting company must want to export.
2. Innovative, unique products help win new markets.

Domestic competition encourages both aspects. Economy of scale is useful but size for WECO is not a problem. It is twice as large as the total of ITT's 28 telecommunications companies worldwide and four times as large as either of the number 3 and 4 worldwide companies. If WECO were limited to even 70% of the BOC and Long Lines market -- as proposed by H.R. 5158 -- it would still be at least three times the size of the next largest competitor. In fact, if WECO were limited to 50% it would still be four times as large as the next largest supplier in the U.S. Market.

With a third or more of the BOC market served by other companies, the U.S. could expect to have several other viable, hungry companies out there competing for orders in world markets. WECO has been in the export market for ten years. In 1980, export sales were still less than 2% of Western's business versus 13% for ITT's U.S. telecommunications divisions. If the U.S. is going to become a larger factor in export it will serve the national interest to have a more competitive domestic industry which can best be spurred on by strong domestic competition.

In conclusion, if BOCs really do set up independent-minded procurement functions, they will -- at least theoretically -- eventually conclude that they need more than one supplier for each product family. We think it is dangerous to depend on theory when the recent practice has demonstrated single-minded maintenance of the status quo. We need procurement limitations as a basic part of industry restructuring.

The general trade companies that are leading the innovation in PABXs are an important part of the entrepreneurial strength of the U.S. They are the ones who have shown the skills that can win against Japanese competition.

We ask that the restructuring of the telecommunications industry include at least interim provisions to ensure an open, competitive market for network products. Give us -- the general trade -- an opportunity to show that we can do the same job for network products that we have done for PABXs.

TESTIMONY OF WILLIAM H. FORSTER

Vice President & Product Group Manager
Telecommunications & Electronics
International Telephone and Telegraph Corporation
New York, New York

REGARDING MONOPOLIZATION AND COMPETITION IN TELECOMMUNICATIONS

June 17, 1981

Thank you Mr. Chairman,

I am William H. Forster, a Vice President of ITT and Product Group Manager for our Telecommunications & Electronics business sector worldwide. I have been with ITT for 15 years. Until 1976, I was Vice President and Technical Director of ITT Europe with responsibility for supervising the research and product development of our telecommunications companies in 15 countries. I am familiar with the products and markets and with the relationships which exist between suppliers of telecommunications equipment and the PTTs.

Since 1976, I have been headquartered in New York with a worldwide responsibility as Product Group Manager.

In the United States, 80 percent of the 185 million telephones are owned by AT&T, 10 percent by GTE and 10 percent by the more than 1500 so called Independent-Independent telephone companies. In discussing competition in the telecommunications equipment manufacturing industry one is forced to look first at the Bell System Market. In addition to having 80 percent of the local telephone lines, Bell's Long Lines is the major factor in the long distance network so that the total AT&T market represents about 85 percent of the telecommunications equipment business.

The FCC in 1977 found that there is a "...bias in favor of Western products (which) limits not only the autonomy and independence of the BOC but also precludes a fair opportunity for the general trade to serve BOCs equipment needs" and that the "...overall Bell System procurement and make/buy decision processes in which BSPPD participates, inherently favor Western". There has been essentially no change in this situation or in the market share of the general trade suppliers in comparison with Western Electric since that time.

Hence, the universal perception and the decision making thinking of the suppliers of telecommunications equipment is that the market represented by the 23 Bell Operating Companies and Long Lines is essentially closed for product families which are manufactured by Western. This is true, as we have found, even in those instances where ITT developed a product demonstrably cheaper and better than the comparable Western product.

This is not surprising. Western Electric has several inherent advantages:

First - Western works with the BOCs and Bell Labs to define the requirements and develop a product tailored to their needs. When the development is complete and Western's production has started the specifications are finalized and given to the general trade. If they then wish to compete, they have to adapt their product to the Bell System specs and then go through the process of having it tested for "suitability to the Bell System requirements".

The net result is that the general trade product is usually not ready for useful production until two to three years after its Western competition is on the market With the decreasing product life which is characteristic of today's electronic products, this means that the general trade product has a market window of, perhaps, four years versus seven for Western. This is such a major competitive disadvantage that it makes it very difficult for a general trade supplier to compete head-to-head with Western.

Second - The working relationships between the operating companies and Western have been built up over the years and constitute a major barrier to outside vendors. Wester Electric is a full member of the AT&T family and the normal instincts of the operating company personnel who make the final purchase decisions can be expected to follow the well proven pattern. One would not expect a manager to be fired for deciding to "Buy Western", whereas a service problem resulting from a decision to buy in competition with Western could be considered "poor management judgement".

- Lastly, the "Life Cycle Cost Analysis" performed on products before they are accepted as "suitable for use in the Bell System" includes participation by Western. There are several factors which are difficult to quantify and which can be interpreted in different ways. The result is that even when a supplier concludes that the data shows his product to be more economic the Bell System studies may very well favor Western.

You will recall that in 1968, the FCC's Carterfone decision first authorized the connection of other-than-telephone company provided equipment to the telephone networks. The major products involved were PABX's -- the office switchboards - and multi-button and key telephones. Prior to that time the telecommunications equipment manufacturing companies which were not affiliated with a telephone company had had little domestic market for these products. Within 5 years, by 1974, the U.S. industry had developed products which were demonstrably competitive in the world market -and - as a side benefit - the Bell Laboratories had put on a crash program to develop a competitive electronic PABX. By 1980, in the short space of 11 years the Bell Operating Companies were losing about 50% of the orders for new or replacement PABX to non-Western products, and U.S. manufacturers were exporting products all over the world. Several U.S. designs have now been adapted to European PTT requirements.

I think we can conclude that the managers of the U.S. manufacturing companies perceived the interconnect market to be open. They invested resources in product development and marketing; the results have been outstanding.

Now let's look at the Bell System market for network products - the switching, transmission & cable equipment. BSPPD reports for the last three years show the following:

Bell System Telecom Product Purchases

$ Billions	1978	1979	1980
From Western	5.6	6.5	7.5
From Gen'l Trade			
Direct	.8	1.0	1.2
Thru Western	.7	.8	.8
Sub-Total	1.5	1.8	2.0
% From Gen'l Trade	21%	22%	22%

These numbers show that the general trade supplied the BOCs with $2.0B worth of telecommunications products in 1980 - up from $1.8B in '79 and $1.5B in '78. The general trade share of the BOC and Long Lines telecom equipment purchases remained constant at about 22%.

The BSPPD reports to the FCC reduce the Western sales to BOCs by the electronic components and subsystems which Western purchases to incorporate into its products - $1.4B in '80. They add this to the $2.0B sales of the general trade to the BOCs and conclude that Bell buys 37% of its telecommunications products from outside.

If, however, you look at the general trade sales of the network products - that is, of switching, transmission and cables - their share is about 10%. This analysis is based on detailed market research as this breakdown is not published by BSPPD. As far as we can tell, the 10% share has not changed over the last three years. I suggest that BSPPD's 37% figure is misleading. The 10% number should be the basis for policy considerations.

The conclusion is: The BOC market for network products is not open. The general trade is selling niche products - products for small markets where the outside supplier has a more competitive design than Western or for which Western has decided that the market is not sufficiently large to justify its own product development. Niches are good profitable businesses, but you can't build a major telecommunications equipment business or win significant export contracts without the core switching and transmission products.

Central office switching is about 50% of the market for network products - by far the most important product family. The cost of developing a line of digital switching equipment today is typically from $100M to $300M. The Independent-Independent market today, is about 750,000 lines per year - 11% of Bell. Five U.S. and four foreign companies are competing for this $300M/yr market - clearly not an economically viable situation. Experience suggests that it can be served effectively by companies such as Western, Automatic Electric which is part of the General Telephone System and Northern Telecom which is affiliated with Bell Canada. It cannot be economically supplied by an independent manufacturer unless he also has access to a major affiliated market. ITT, of course, looks forward to penetrating the Bell switching market, but the structural relationships between Western and the BOCs and the industry experience of the last three years suggests that our business strategy may not be realistic. Also, our ability to compete in export markets from our U.S. base is dependent upon having a domestic market which is large enough to cover the cost of product development.

In conclusion, I suggest that the experience of the U.S. telecommunications industry in selling to the Bell System shows that the BOC market for major network and office switchboard products is essentially closed to general trade suppliers. On the other hand, if by structural changes it were possible to create a market which was in fact open, we could expect the same kind of dynamic performance in selling to BOCs that the industry has demonstrated so outstandingly in building its 50% market share in the "interconnect" market.

Thank you Mr. Chairman.

P.S. The paper by William H. Forster entitled: The Bell System As a Market, which was presented before the Electronic Industries Association Symposium on Telecommunications Trends & Directions - Hyannis, Mass., May 27, 1981 is appended.

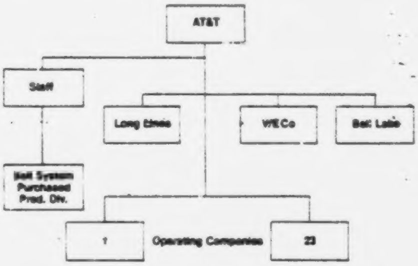
THE BELL SYSTEM AS A MARKET*

By William H. Forster
Vice President and Product Group Manager,
Telecommunications and Electronics
International Telephone and Telegraph Corporation; New York, N.Y.

The EIA has asked me to speak on the Bell System market. I expect Mr. Himsworth invited an ITT speaker because we have been leaders in encouraging the Bell System to further open its market to outside suppliers or, in the nomenclature of the Bell System, to the "general trade." AT&T and ITT have had some well-publicized legal battles that have been resolved — but, on the other hand, the Bell System has been a good and valued customer for many years and we look forward to expanding that relationship. I will do my best to describe the Bell System market — at least as we perceive it — and to show where and in what way a company like ITT participates.

The organization chart of AT&T (Figure 1) shows the key units that buy telecommunications products and systems. The 23 Bell Operating Companies plus Long Lines are the customers, each with its individual personality and tradition — they are 23 different customers. The Bell System Purchased Products Division (BSPPD) is part of the AT&T Staff Department. It serves as an access point and a coordinator for the general trade. It negotiates some umbrella contracts based on qualifying a general-trade product as suitable for Bell System requirements. The BSPPD is not intended to be a bottleneck; rather, it encourages direct sale to the BOCs and Long Lines.

Figure 1 — Bell System Structure.



Before discussing the Bell System's market quantitatively and by product family segments, I would like to propose a qualitative framework to evaluate the probability of success in selling to the Bell System.

Bell procurement policy varies markedly depending upon whether or not Western Electric is a potential supplier. I have chosen four categories:

- **Commodities** include telephone poles, building materials and many other products. They are widely available, but also products that WECo specifically doesn't make. Bell is a good customer for commodities. They write clear specifications, know what they want and they pay fair prices.
- **Niche products** include many varieties of electronic equipment including specialized test instruments and some network and end-user products that are procured in quantities judged to be more appropriate for small companies or divisions of large companies rather than for WECo. Again, Bell is a good customer. They work with their suppliers and demand high performance and excellent reliability. Their planning processes make it practical to build a responsive supplier organization and the Bell stamp of approval is respected and valued around the world. There are several companies represented in this room today that got their start as a supplier of a niche product to the Bell System.
- For **network products** and **customer premise equipment**, WECo is a worthy and increasingly aggressive competitor. WECo people fight for market share just like the rest of us. This area is the center of the legal and regulatory debate.

Globally, the Bell System market is huge (Table 1). The construction budget for 1979 was $8.3 billion for telecommunications products — up 17% from 1978. In addition, it was $7.5 billion for non-telecommunications products such as automobiles, buildings, furniture, etc., and for services. These numbers come from an AT&T report submitted annually to the FCC. The 1980 numbers will be out shortly.

TABLE 1

1979 CONSTRUCTION BUDGET

Dollars in Billions

	1978	1979	% Change
Telecom Products	7.1	8.3	+ 17
Non-Telecom Prod or Servs	6.6	7.5	+ 14
Total	13.7	15.8	+ 15

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*Presented before the Electronic Industries Association Symposium on Telecommunication Trends and Direction, Hyannis, Mass., May 27, 1981.

First, let's examine how the telecommunications products were procured (Table 2): $5.5 billion of the $8.3 billion in telecommunications products were manufactured by WECo. The general trade sold $1.8 billion of finished products in 1979, up from $1.5 billion in 1978. Of the $1.8 billion in 1979, $1 billion was procured directly by the BOCs and $800 million came in through WECo acting as purchasing agent. In addition, WECo purchased another $1 billion worth of components. In the WECo definition, this category includes electronic subsystems from minicomputers to ICs, but not raw materials such as copper bars or paint. The outside suppliers' share of finished products was 21% and 22% for 1978 and 1979, respectively. Including components and subsystems raises the share to 31% and 34%. These are the official BSPPD figures.

TABLE 2

1979 TELECOM PRODUCT PURCHASES

Dollars in Billions

	1978	1979
BOC Direct	0.8	1.0
BOC thru WECo	0.7	0.8
Components for WECo Prod	0.7	1.0
Total	2.2	2.8

When the 1980 numbers are released, they will probably show that the general trade share of products continued at around 22% and that the volume of components and subsystems rose to about $1.4 billion.

Now, let's break the $7.1 billion Telecom Products Construction Budget for 1978 down into 11 product families to examine the details of general-trade sales (Table 3). These data are not available from BSPPD, but come from a comprehensive 1978 study prepared by Sonneville Associates of Crystal Lake, Illinois. The numbers have not been confirmed precisely by the BSPPD, but they seem to be reasonable.

TABLE 3

1978 TELECOM PRODUCT FAMILIES

Dollars in Millions

	Total	Gen'l Trade	% from Gen'l Trade
CO Switchers	2,100	200	10
Microwave	88	38	43
Transmission Equip	772	120	16
Cable & Wire	1,211	100	8
Station Apparatus	1,471	200	14
Large PBXs	250	10	4
Poles & Hardware	86	86	100
Conduit	200	200	100
System Minicomputers	150	150	100
Office Computers	70	70	100
Supplies	392	392	100
Total	7,155	1,666	23

Central office switching dominates. We suppliers have a 10% share, but I suspect that this is primarily ancillary switching products such as message-accounting, traffic-measuring and test equipment. The amount of basic switching equipment procured from sources other than WECo has been and is negligible. This spring, both Northern and ITT have cut over digital switches for New York TelCo. ITT's System 12 exchange with a co-located remote subscriber unit was put into traffic in Syosset, New York on February 28. Installation was done by WECo craftsmen under ITT supervision and from the reports of the NY TelCo management, the performance is excellent. Obviously, we are pleased and we look forward to increasing our portion of that 10% share of the Bell System market in coming years.

The $88 million of microwave equipment is a low-volume product requirement for the Bell System. The 43% captured by the general trade would be small business for WECo, but it is a major business segment for a specialist company such as, say, California Microwave. Recently, this segment has been growing rapidly.

Transmission includes multiplex and line equipment. Of the $772 million in 1978, $120 million went to the general trade. A significant fraction of this consisted of digital channel banks and repeaters from ITT. This market share is getting smaller. Translation: WECo is becoming more competitive.

Transmission products offer an example illustrating how a combination of factors is decreasing some market windows for the general trade. First—product life is down—now typically six to eight years. ITT modestly considers itself a leader in transmission technology. We are second in sales worldwide only to WECo. We have the latest technology available, but we can't start to develop the final product until we get the specifications. WECo develops its products in close collaboration with the BOCs. Only when the development is complete and the product is accepted by the BOCs and in production, are the specifications released to the non-Bell world.

The cycle for development and the establishment of volume product takes a minimum of two years. Qualification testing, field trials, and acceptance of the product as "Suitable for the Bell System" take a minimum of 18 additional months. As a result, the market life for a general trade product is typically down to four years versus seven years for WECo. This is such a significant competitive disadvantage that general trade suppliers are essentially precluded from selling to BOCs those products that compete head-to-head with WECo.

Cable and Wire is a WECo strength. ITT manufactures telecommunications cable in eight countries, but in the U.S. we compete with WECo only in the new area of optical fibers. Market research projects telecommunications cables as a shrinking business, so we can expect WECo to fight very aggressively to maintain volume in its factories.

Station apparatus includes telephone subsets, key systems and smaller PABXs. It is the second largest product family, comprising 70% of switching in 1978 but growing rapidly. I would expect that the figures for 1979 and 1980 will show WECo and the Bell System continuing to lose market to "interconnect" companies, including ITT.

In March 1982, the Bell System will be required by the FCC to handle new customer premise equipment through a nonregulated, arms-length subsidiary. We can expect significant changes in market positions. I can't resist the temptation to report to you that ITT's Telecommunications Division in Canada has signed a nonexclusive distribution agreement with Bell Communications Systems, Inc., Canadian Bell's nonregulated interconnect company. BCS will sell ITT's new System 3100. This hybrid key system and PABX won out in competition with Northern and Mitel in the 40-to-120-line range. You all know that Bell Canada is no longer a subsidiary of AT&T, but we hope that some of the BOCs will follow the example of their Canadian cousin in the years ahead.

Large PBXs totaled $250 million, with only 4% coming from the general trade. Some of this was ITT. A more meaningful figure would include interconnect sales in BOC territories as part of the general trade market share.

For these six product categories, the general trade competed with WECo—and not very successfully. This contrasts with PABXs, for which the general trade has carved out a 35% market share in competition with the BOCs.

For the last four product categories and miscellaneous, we scored 100%. ITT is a major supplier of telephone poles. DEC provides minicomputers used in network systems such as message accounting, network management and maintenance diagnostics processing, but this category does not include computers used in main-line switching projects, which are classified under central office switches.

Sonneville shows 23% market share for the general trade, 2% higher than the BSPPD number. For the network and end-user products, the $5.9 billion for the first six categories, the general trade share is only 11%.

So much for the market; now a few words on the regulatory and legal environment.

In 1977, the FCC concluded that the Bell System should open its market to the general trade. I have extracted three statements from the FCC's findings:

- A "...bias in favor of Western products [which] limits not only the autonomy and independence of the BOC's, but also precludes a fair opportunity for the general trade to serve BOC's equipment needs."
- "...the overall Bell System procurement and make/buy decision processes, in which BSPPD participates, inherently favor Western."
- "AT&T has never developed any management structure to insure either that the products of the general trade manufacturer will receive fair and serious consideration for use in the Bell System or to insure that operating companies do purchase the best available equipment whatever the source."

Naturally, I would not disagree with the FCC on this matter. The record stands.

How did the Bell System react to the FCC's conclusions? This is the way it looked to us. WECo continued its close relationship with the Bell Labs and the operating units—a relationship highly privileged compared to the position of the general trade suppliers.

BSPPD increased its manpower, but in all fairness it must be said that the crucial "buy decisions" are with the line organizations—and rightly so. BSPPD tries to help but we all know that line organizations like to show their independence of staff groups.

AT&T proposed a new "procurement entity" which was to be more of a line-type organization and would actually do procurement for BOCs in a manner somewhat similar to the way WECo does some buying for the BOCs. The FCC was not convinced that this would be a step forward and nothing has been done to implement the proposal.

Lastly, most significantly, and not unexpectedly, WECo has become more competitive. If the objective of the general trade were to increase its sales of product families in competition with WECo, one might conclude that challenging the Bell System's procurement policies turned out to be counterproductive.

There continues to be high visibility for major litigation concerning Bell System procurement practices. You all know that AT&T and ITT settled an antitrust suit a year ago. The details are in the record.

Procurement policies and the role of WECo in the Bell System are major issues in the Justice Department's current antitrust suit. Many lesser law suits have been settled out of court. But one thing is sure—the relationship between BOCs, WECo and the general trade will continue to evolve and no one can predict the precise market environment even for as little as two years ahead.

I would like to conclude by listing four areas for continuing attention:

- WECo is changing. We can expect the organization and its actions in the marketplace to become increasingly competitive, perhaps acting more like us general trade suppliers.
- The availability of multiple sources of supply for the BOCs might be expected to encourage local operating management to take more aggressive actions to reduce costs and improve services to us all—the subscribers.
- We all operate more efficiently under the spur of competition. There is no reason to assume that the units in the Bell System are different from the rest of us.
- And lastly, the Bell System is and will continue to be a large customer. We general trade suppliers should observe the changing patterns in the four market categories that I defined earlier —commodities, niche products, network products and customer premise equipment—and we should design our strategies to make the most of the Bell System market opportunity with realistic evaluation of the needs our products can fill in that market.

Mr. WIRTH. Mr. Morris.

STATEMENT OF MICHAEL H. MORRIS

Mr. MORRIS. Thank you, Mr. Chairman.

I am Michael H. Morris. I am senior attorney for ROLM Corp. of Santa Clara, Calif., a manufacturer of computerized private telephone switching systems and advanced military computers.

The proposed settlement has not, in any significant way, affected the need for comprehensive telecommunications legislation such as that embodied in H.R. 5158. There are two reasons: first, the settlement agreement is sketched in only the broadest terms—in some ways it is nothing more than an agreement to agree—and it is silent on several issues that are critical to the maintenance of a truly competitive, deregulated telecommunications industry. Second, the potential for monopoly abuse, and the need to assure that it does not occur, will exist in the "new A.T &. T." to the same extent that it did under the presettlement A.T. & T.

Accordingly, ROLM Corp. believes that the proposed settlement should be looked upon as a new starting point for congressional action and not as a resolution to the deregulation problems of the telecommunications industry.

There is no need to remind this subcommittee, I am sure, of the number and complexity of the questions inherent in the deregulation of telecommunications. In some ways, the settlement agreement may raise more questions than it attempts to answer. Because time does not permit the most exhaustive review of the settlement agreement, I have confined my comments to those relatively few areas that we consider to be of the greatest importance and have, of course, done so from the perspective of a terminal equipment manufacturer. Naturally, any company's priority of concerns on this matter is bound to be determined largely by the segment of the telecommunications industry in which it operates. Furthermore, I have not attempted any direct comment on the provisions of H.R. 5158 inasmuch as today's focus is on the settlement, and I know ample opportunity will be provided by the subcommittee for discussions of the specific provisions of the proposed legislation.

The proposed settlement does not eliminate the opportunity for the "new A.T. & T." to abuse monopoly power and revenues. It will have a continuing virtual monopoly over regulated long-distance transmissions and a virtual monopoly over most terminal equipment. The revenues derived from long-distance services alone are enormous, and the diversion of only a small portion of these revenues could improperly and decisively benefit its deregulated offerings. For terminal equipment manufacturers, cross subsidies form the heart of concern.

The spinoff of the operating companies will not, to any extent, eliminate Bell's dominance of long distance and telephone equipment markets. One can make an argument that spinning off the operating companies could result in greater dominance, since all of the new A.T. & T.'s resources can be concentrated on interexchange services and terminal equipment.

In our judgment, H.R. 5158 provides the best legislative approach to deregulation which has thus far been proposed in Congress and, when applied to the "new A.T. & T.," can go far toward creating the kind of climate in which telecommunications competition, with all its benefits, can flourish.

Since the settlement modifies the 1956 consent decree under which A.T. & T. was required to license its patents and provide technical data in exchange for reasonable royalty payments, new A.T. & T., containing Western Electric and Bell Laboratories, could refuse to license technology at the expiration of current license agreements even though that technology was created with revenues derived from its past monopoly position and even though future products may be developed with regulated, monopoly-derived long-distance revenues. Unless patent licensing continues to be required by legislation or judicial decree, it will be virtually impossible for competitors to manufacture noninfringing telecommunications equipment. Furthermore, A.T. & T.'s patents represent an enormous investment by ratepayers over the years. Provisions should be made for disbursement of some royalty payments to the ratepayers' benefit, perhaps, by payment to the separated Bell operating companies in order to hold down local rates.

Eventually, the existence of the two completely separate companies the settlement proposes will end the operating companies' exclusive reliance on Western Electric for equipment. But it is unrealistic to think that any natural weaning away will occur except in the very long run. In the meantime, old habits and loyalties die hard, and we believe that there is a continuing need for equipment purchase quotas, such as those contained in section 243 of H.R. 5158, requiring the operating companies to buy equipment from non-Western Electric vendors until such time as the market for telephone equipment is fully competitive.

Since the settlement does not detail the manner in which A.T. & T.'s assets will be divided between the new A.T. & T. and the operating companies, we are left to speculation. We believe it is safe to speculate that A.T. & T. will attempt to allocate all possible costs to the operating companies. If that happens, ratepayers will have to bear the ultimate cost. Among other things, it is essential that the operating companies not be burdened with plant and equipment they cannot use or which is overvalued.

We also believe that the Federal Communications Commission should retain ongoing jurisdiction in much the same manner as is provided in H.R. 5158, a question on which the settlement is largely silent.

The new A.T. & T. should not be permitted to continue its use of the Bell name or the trademarks and symbols of the old A.T. & T. in pursuing sale and distribution of unregulated goods and services, a question on which the settlement is also silent.

Mr. SCHEUER [presiding]. Off the record.

[Discussion off the record.]

Mr. MORRIS. We want to impress upon the committee our essential view that the settlement agreement between the Justice Department and A.T. & T. does not in any way affect the responsibility and the need, we think, for this committee to address a legislative final solution to the question of how you deregulate telecommunications. We urge that that continue, and believe that the combination of the basic terms of the settlement agreement, the separation of A.T. & T. into two companies and superimpose most of the provisions provided by H.R. 5158, particularly with respect to the unregulated A.T. & T., will go 95 percent down the road to solving the problems that we face as we confront the issue of deregulating telecommunications.

[Mr. Morris' prepared statement follows:]

STATEMENT OF

MICHAEL H. MORRIS
Senior Attorney
ROLM Corporation

I am Michael H. Morris. I am Senior Attorney for ROLM Corporation of Santa Clara, California, a manufacturer of computerized private telephone switching systems and advanced military computers. On behalf of ROLM, I want to express appreciation to the Subcommittee for the opportunity to appear before you today to express our views on the implications for telecommunications deregulation of the proposed settlement of the anti-trust suit between the United States Department of Justice and American Telephone & Telegraph Company.

The proposed settlement has not, in any significant way, affected the need for comprehensive telecommunications legislation such as that embodied in H.R. 5158. There are two reasons: First, the settlement agreement is sketched in only the broadest terms--in some ways it is nothing more than an agreement to agree--and it is silent on several issues that are critical to the maintenance of a truly competitive, deregulated telecommunications industry. Secondly, the potential for monopoly abuse, and the need to assure that it does not occur, will exist in the "New AT&T" to the same extent that it did under the pre-settlement AT&T.

Accordingly, ROLM Corporation believes that the proposed settlement should be looked upon as a new starting point for Congressional action and not as a resolution to the deregulation problems of the telecommunications industry. That is the first assumption ROLM makes.

Our second assumption is that the proposed settlement will remain basically unchanged by the District Court--a large assumption, to be sure, but the only one possible for this discussion. Furthermore, one must make allowance for the possibility that the plan whereby AT&T will implement the settlement may contain measures that significantly affect the necessity for or the nature of legislation. There may, indeed, be "devils in the details" of that plan. We shall see.

There is no need to remind this Subcommittee, I am sure, of the number and complexity of the questions inherent in the deregulation of telecommunications. In some ways, the settlement agreement may raise more questions then it attempts to answer. Because time does not permit the most exhaustive review of the settlement agreement, I have confined my comments to those relatively few areas that we consider to be of the greatest importance and have, of course, done so from the perspective of a terminal equipment manufacturer. Naturally, any company's priority of concerns on this matter is bound to be determined largely by the segment of the telecommunications industry in which it operates. Furthermore, I have not attempted any direct comment on the provisions of H.R. 5158 inasmuch as today's focus is on the settlement and, I know ample opportunty will provided by the Subcommittee for discussions of the specific provisions of the proposed legislation.

CROSS-SUBSIDIES

The proposed settlement does not eliminate the opportunity for the "New AT&T" to abuse monopoly power and revenues. It will have a continuing virtual monopoly over regulated long distance transmissions and a virtual unregulated monopoly over most terminal equipment. The revenues derived from long distance services, alone, are enormous and the diversion of only a small portion of these revenues could improperly and decisively benefit its deregulated offerings. For terminal equipment manufacturers, cross-subsidies form the heart of concern.

For terminal equipment manufacturers like ROLM, the most important parts of H.R. 5158 are those which are designed to prevent cross-subsidies and tying arrangements between the regulated and unregulated portions of AT&T. Separations requirements of various kinds and continuing oversight by the FCC are the means by which cross-subsidies are to be prevented. The spin-off of the operating companies will not, to any extent, eliminate Bell's dominance of long distance and telephone equipment markets. One can make an argument that spinning off the operating companies could result in greater dominance since all of the New AT&T's resources can be concentrated on inter exchange services and terminal equipment. Accordingly, the separations requirements, FCC oversight, and the interconnection obligations contained in 5158 should be applied to the new AT&T as strictly as they would have been applied to the old AT&T.

In our judgement, H.R. 5158 provides the best legislative approach to deregulation which has thus far been proposed in Congress and, when applied to the "New AT&T", can go far toward creating the kind of climate in which telecommunications competition, with all its benefits, can flourish.

PATENTS

Since the settlement vacates the 1956 Consent Decree under which AT&T was required to license its patents and provide technical data in exchange for reasonable royalty payments, New AT&T, containing Western Electric and Bell Laboratories, could refuse to license technology at the expiration of current license agreements even though that technology was created with revenues derived from its past monopoly position and even though future products may be developed with regulated, monopoly derived long distance revenues. Unless patent licensing continues to be required by legislation or judicial decree, it will be virtually impossible for competitors to manufacture non-infringing telecommunications equipment. Furthermore, AT&T's patents represent an enormous investment by rate payers over the years. Provisions should be made for disbursement of some royalty payments to the rate payers' benefit, perhaps by payment to the separated Bell operating companies in order to hold down local rates.

EQUIPMENT PROCUREMENT BY OPERATING COMPANIES

Eventually, the existence of the two completely separate companies the settlement proposes will end the operating companies exclusive reliance on Western Electric for equipment. But it is unrealistic to think that any natural weaning away will occur except in the very long run. In the meantime, old habits and loyalties die hard, and we believe that there is a continuing need for equipment purchase quotas, such as those contained in Section 243 of H.R. 5158, requiring the operating companies to buy equipment from non-Western Electric vendors until such time as the market for telephone equipment is fully competitive.

DIVISION OF ASSETS

Since the settlement does not detail the manner in which AT&T's assets will be divided between the new AT&T and the operating companies, we are left to speculation. We believe it is safe to speculate that AT&T will attempt to allocate all possible costs to the operating companies. If that happens, rate payers will have to bear the ultimate cost. Among other things, it is essential that the operating companies not be burdened with plant and equipment they cannot use or which is over-valued.

FCC JURISDICTION

The Federal Communications Commission should retain on-going jurisdiction in much the same manner as is provided in H.R. 5158.

TRADEMARKS

The new AT&T should not be permitted to continue its use of the Bell name or the trademarks and symbols of the old AT&T in pursuing sale and distribution of unregulated goods and services.

YELLOW PAGES

Yellow Pages revenues should flow to the operating companies, not to the new AT&T. It makes far more sense that revenues derived from the local advertisers and phone books distributed at the local level remain with the local's telephone service company. The value of Yellow Pages advertising is a direct function of AT&T's monopoly status. The regulated local operating companies are the proper repositories for that value.

INSIDE WIRING & EMBEDDED CPE

The proposed settlement is unclear regarding which part of AT&T will have ownership of inside wiring. This is a critical question since inside wiring is a "bottleneck" facility. That being the case, we think it beyond doubt that the inside wiring should be owned by the regulated entity, not by the "new" AT&T and that users be given the option of continuing to rent such wiring under tariff or to purchase it at fair value. Similarly, the fate of embedded customer premises equipment ("CPE") is unclear under the settlement agreement. As with inside wiring, it seems sensible that embedded CPE remain in the operating companies and not go to the new AT&T and that it continue to be offered by the operating companies under tariff with an option to users to purchase it at fair value. Among other beneficial effects, retaining embedded CPE within the operating companies will avoid some extremely difficult assets valuations problems. To the extent that assets valuations problems cannot be avoided, it seems indisputable, as a general matter, that any transfers from the operating companies to the new AT&T be at fair market value or book value, whichever is higher,in order for monopoly rate payers fully to recover their past investment.

CONCLUSION

Our review of the proposed settlement leaves us firmly convinced that clarifying legislation such as H.R. 5158 is needed now more than ever. Standing alone, the settlement is profoundly anti-competitive in the long run even if a company like ours can see certain short term advantages from it. On the other hand, implementation of the settlement within an industry deregulated according to the principles embodied in H.R. 5158 ought to assure genuine competition, geniune innovation, continued American technological leadership and widespread availability of telecommunications goods and services of the highest possible quality and lowest possible cost.

Mr. **Scheuer**. Would any of you like to respond to any remarks that your colleagues on the panel have said before I have a go at it?

All right. Let me ask this. Although this hearing today is supposed to focus on the settlement, during the course of the previous hearings and we began to discuss the whole problem of exports and imports and the barriers that were placed in the way of American exporters, particularly from Japan, and the need to enable the American telecommunications industry to sell abroad and compete fairly and successfully in global competition.

The two manufacturers here are worried about Japanese imports. Are you worried about the ability of our telecommunications industry, your firms and others, to compete against the Japanese, the West Germans, the Swedes, the Canadians, and the French? How do you size up the free flow of ideas and commerce across national boundaries, both our ability to export successfully and our ability to maintain a domestic industry here without exporting jobs and capital abroad?

Mr. **Forster**. Mr. Chairman, first, with respect to meeting the needs of the telecommunications operating entities here in the United States, you basically need to be a local presence. You cannot export from Germany or Japan and have a really close working relationship with your customers, who have a lot of technical problems. It is a very complex interface. So I would suggest that generally speaking what could be expected to happen if the market is opened is that there may be foreign suppliers who will set up shop in the United States with U.S. subsidiaries, and clearly that is very fair competition, but it is also true that in order to sell into this industry you have to be leading with features and performance, and that of course you do if you have to work like a beaver to compete. So that the domestic competition is essential I think if the manufacturers that are serving the U.S. industry are going to be able to hold it.

When it comes to exporting, that is a very difficult business. You really have to want to do it and work very hard at it, and I think you have to let the record speak for itself. U.S. companies have advantages in some markets, Japanese companies have advantages in others, and if you look at the record of the U.S. companies, I suspect you will find it is getting better year by year. If you look at European companies, our companies, the export record is very good. I think we have to take on the Japanese head-on.

Mr. MORRIS. If I might comment, I would like to point out that in Hong Kong, ROLM Corp. replaced traditional Japanese manufacturers as a supplier to the Hong Kong Telephone Co. of PABX's because we provided the best product, the lowest possible cost, and best service potential. Here you had a market dominated by the Japanese where an American firm went in and took that market away. Our international division is by far the fastest growing division in the company. We are expanding into Europe in a market which has been traditionally closed. We have taken on a trading company in Japan itself and expect to do good business in that country. We do not fear competition in the United States or abroad, where our record speaks for itself.

Mr. LAFER. In the data processing services, I would not like to leave the impression that the international and foreign area is only a concern in the manufacturing of equipment. Data processing services companies are very much concerned, and indeed H.R. 5158 does deal with reciprocity, requiring basically that foreign companies providing telecommunications in the United States be subject to the same kind of limitations as American companies are subject to in the foreign countries. We do not have the same freedom of international operation in supplying telecommunications services overseas as companies do here. I suggest to you that the international——

Mr. SCHEUER. As foreign companies do to sell here?

Mr. LAFER. Selling in the United States. The international problem is not just limited to equipment, and I do not mean to take away from the ability of equipment people to sell, but please recognize that we have a serious concern in our ability to have a free flow of information so our data processing services installations in foreign countries can bring information here to process in the same way that we permit foreign companies to come into the United States and process elsewhere.

Mr. SCHEUER. Mr. McGowan, you are getting into the international telecommunications business with your acquisition of Western Union. Do you wish to comment on this matter?

Mr. McGOWAN. Most of my experience is as a user of telecommunication products in the United States. We buy a substantial amount of equipment. Our capital budget this year will be $400 million. When I first started in business, I had to go overseas. The only people that made equipment we needed were Western Electric, General Telephone, and Collins, and I insisted on two suppliers. I prefer to sleep somewhat well at night.

Since the long-distance industry has now become more competitive in that we and others in the industry are buying a substantial amount in the United States, there must be at least 15 new suppliers of telecommunications equipment responding to a market, and they were not in the business before. So we are encouraged. The only way to encourage people is by writing checks.

We were able to buy equipment. Under the consent decree we will be able to buy equipment from Western Electric. We have a telecommunications school in our business. We have a school for profit where we teach people how to buy telecommunications equipment for communications managers and large corporations. Our people will teach them how to buy PBX's, how to buy their equipment as a user's equipment. We have a school teaching them how to buy Dimension, ROLM, and everybody else's. We would not buy Western Electric, not their PBX's, but some of their other equipment. If they supply good equipment to us after the consent decree is in, we are a buyer if we can get a good price. So the advent of the kind of open competition which in the areas like equipment that this consent decree intends to have is going to improve their ability to be a better exporter as well as everybody else's.

Mr. SCHEUER. Let me just ask you very briefly as the last question—because we must be out of here a little bit before 5 o'clock—this consent decree in its terms sort of unleashes Ma Bell. Are there any persuasive reasons why the 22 BOC's should not also be unleashed to utilize new technologies and expand into all kinds of operations, for example cable TV, equipment production and sales, satellite services, digital termination services, distribution of electronic yellow pages and the like? Underlying that question is a concern of the danger that we may be restricting the BOC's in the same manner that A.T. & T. was restricted in 1956.

On the bottom line I am asking what is your understanding of the relative freedom of A.T. & T. and the 22 local operating companies, the BOC's, to offer competitive services over the local wires?

Mr. MCGOWAN. I will give you my opinion very briefly. It would be a destruction of the consent decree. You would reverse it. You may as well pass a bill and stop them from negotiating, to allow a company that is providing a monopoly service to go back in a competitive service. The reason they prosecuted successfully is that Bell used the local phone company to help them where they were competitive. On the long-distance side they would not let competitors connect to it. The concept of the consent decree says fellows, if you are a bottleneck, that is where you stay. The concern is, are they healthy? That is a license to make money. They would still be regulated by the States.

Mr. SCHEUER. The local companies were subsidized by the long-distance lines.

Mr. MCGOWAN. They lied when they said that. The figures proved otherwise. You know the first time in the history of telecommunications when that was mentioned was in the middle seventies. Read the Ozark plan. The title of the plan is "Toll Rate Disparity." They were trying to cure the difference in toll rates between the State and Federal jurisdictions, not lower local rates. It is a red herring.

Mr. SCHEUER. You do not see any way that the BOC's could be turned loose to compete and deliver competitive service on some assurance that in their accounting and in their pricing they would have equal access to their lines but not have a competitive advantage?

Mr. MCGOWAN. We have had the Communications Act, the antitrust laws, every possible legal procedure, FCC, everything possible, and they went ahead and did it. The purpose of the decree is to do that one thing. There may be other things needed, but if you disturb that, you disturb the rationale of it.

Mr. SCHEUER. I will ask unanimous consent that any of you who wish to expand your remarks on this question or any other question can submit them in writing.

Mr. LAFER. We have a basic philosophy that whoever competes compete on an equal basis with the others. As long as you follow the philosophy of H.R. 5158, let there be 22 competing companies as long as there is structural separation. I was concerned about your comment about an accounting separation because I do not think that is possible, and neither does the GAO. They have said you cannot have it federally, and I do not believe it can happen at the local companies.

Mr. SCHEUER. How do you meet Mr. McGowan's problem with the BOC's controlling the local lines one way or another——

Mr. LAFER. I am saying if in the wisdom of the separation it is determined that they cannot be healthy and there is not an entity, I suppose they have to be separated, and I think we are down to structural separation. What I am suggesting is you cannot combine regulated monopoly businesses with unregulated businesses and hope to have the kind of development in this country as we have demonstrated in the data processing services industry. All these new jobs, technology, and a flourishing industry, you cannot do it by combining. You will put the unregulated out of business.

Mr. FORSTER. There is a problem caused because here we have 20 percent of the local operating companies that have no such restrictions on them. GTE—since nationally Bell and Sned are part of it and the independents and there is no clean way that has been proposed yet to handle the problem which my colleagues are raising, it does not seem to me the settlement is consistent when it treats different people differently on the basis of parentage.

Mr. MORRIS. Our view is if the new local monopolists want to enter competitive arenas, they ought to spin off new companies, and in that case we do not have a problem. If you have a separate subsidiary type of situation, we think there lies disaster.

Mr. SCHEUER. Thank you very much.

The last panel will now come forward: Commissioner Robert Litke of the department of general services, New York City; Robert Bennis, director of telecommunications for Westinghouse Telecomputer Center in Pittsburgh; and Mr. Samuel Simon, executive director of the National Citizens Committee for Broadcasting.

Gentlemen, we are very happy to have you here. I regret that we are pressed for time. We must be out of here before 5 o'clock, so I am going to ask each of you to restrict your remarks to 5 minutes. We will operate under the 5-minute rule, and I am sure you are capable of doing that effectively. Your remarks will be printed in full at this point in the record.

With that let me ask Mr. Simon, Mr. Bennis, and Mr. Litke to address us.

Mr. Simon.

STATEMENTS OF SAMUEL A. SIMON, EXECUTIVE DIRECTOR, NATIONAL CITIZENS COMMITTEE FOR BROADCASTING; ROBERT E. BENNIS, ON BEHALF OF INTERNATIONAL COMMUNICATIONS ASSOCIATION; AND ROBERT M. LITKE, COMMISSIONER, DEPARTMENT OF GENERAL SERVICES, NEW YORK CITY

Mr. SIMON. Thank you very much for the opportunity to appear here today, and since my testimony will be printed in the record in full, I would like to focus on two points that are perhaps most specifically of concern today, both involving the question of consumer or residential user participation both in the process of the settlement process as well as later on.

The proposed consent decree will not go into effect until approved by Judge Greene. While we support the Tunney Act review process, we believe that the residential and small business end users will not adequately be represented during this process. Consequently NCCB, along with Public Citizen and other consumer representatives, yesterday filed a petition with Judge Greene seeking to have him appoint a consumer expert or panel of experts to advise the court on whether and under what circumstances the settlement should be accepted from the point of view of the residential end user. At this point I would like permission to provide copies of that motion and supporting documents for the record.

Mr. SCHEUER. By all means.

Can you tell us what public policy issues that are suggested by the consent decree that we ought to be biting the bullet on? What public policies should we be addressing that are suggested by the consent decree?

Mr. SIMON. Those are listed in the testimony. It is difficult without the benefit of this expert analysis that we are seeking to fully predict which are the most important issues. We have outlined some of greatest concern to us.

First is Bell Laboratories. The proposed order seems to not to consider the legitimate interest of the local operating companies and customers in Bell Laboratories. Under the proposed settlement patents and technologies developed with ratepayer funds will be the sole property of A.T. & T. We believe there ought to be disclosure of the work in progress, developed by ratepayers' funds, which is for or related to local operating exchange services.

Second, the division of responsibility between A.T. & T. and the operating company raises concerns as to how A.T. & T. can assure the financial viability of operating companies without forcing local exchange rates to skyrocket. Already serious concerns have been raised by various parties about the loss of revenues faced by the operating companies in the transfer to A.T. & T. of the yellow pages and customer-premises equipment. It is clear there is a potential for tremendous consumer cost impact through higher rates as a result of the divestiture. There is the potential for loss of major revenue sources to local operating companies.

One of the most serious flaws in the consent decree is the degree to which A.T. & T. is given control over devising the plan for divestiture, including the decision on the number and structure of the operating companies to be created. It is our view that the short and long term interests of the operating companies in the divestiture process are not necessarily identical to the interests of American Telephone and Telegraph, and therefore a somewhat adversarial relationship ought to exist as the divestiture plan is developed. We believe Judge Greene should require the creation of an entity to represent the operating companies' interest in the divestiture process. It could be composed of representatives of the operating companies, representatives of the State regulatory commissions, and/or consumer or public councils.

The additional area that I wanted to mention during the brief comments concerns the establishment of an organization to represent in the long term the interests of the residential end user. Today, as we go about the business of restructuring the telecommunications industry, we should also take the opportunity to provide for the establishment of such a structure to enable customers to organize and effectively represent themselves. As a result of the consent decree it is likely that there will be created a number of large regional operating companies with monopoly control over local exchange service. Nationally A.T. & T. will continue its monopoly position in the long-distance market for the foreseeable future.

In this brave new world of deregulated competition and large regional monopolies we think there must be a large, effective organization dedicated to the representation of the interests of residential telephone users. Just last week Representative Mottl introduced legislation H.R. 5421, which if enacted will accomplish the goal of assuring effective consumer participation in the rapidly changing communications environment. The National Telecommunications Consumer Board Act provides that exchange and interexchange carriers must include notices with their bills inviting residential telephone consumers to join an organization which would in turn represent them before rate-setting and other governmental bodies. Any residential telephone consumer 16 years of age or older will be able to join the organization by paying a nominal annual membership fee.

Mr. SCHEUER. Could you please summarize your statement.

Mr. SIMON. It is clear that throughout the process we are facing that informed citizen participation should be permitted and encouraged. Therefore we have urged Judge Greene to appoint a consumer expert and encourage that this committee look at H.R. 5421 as a means for establishing representation for consumers in this area. Thank you.

[Testimony resumes on p. 515.]

[Mr. Simon's prepared statement and attachment follows:]

Testimony of

SAMUEL A. SIMON

Executive Director

National Citizens Committee for Broadcasting

Good morning, Mr. Chairman. I would like to thank you and the subcommittee for the invitation to appear today to address from a consumer perspective the Department of Justice decision to settle its antitrust suit against AT&T.

The National Citizens Committee for Broadcasting is a telecommunications research and action center chaired by Ralph Nader. It is the oldest and largest organization of its kind. On behalf or our over 8,000 individual supporters and 120 group members, we work to promote a diverse and democratic communications system responsive to the public interest.

In the last several years, NCCB has been the foremost consumer voice in the national debate over the future of telecommunications.

NCCB's involvement has taken many forms. We have carefully covered the debate in ACCESS, our biweekly journal of telecommunications news and comment from a consumer perspective. We published an immensely successful guidebook to telephone consumerism in the competitive communications era, REVERSE THE CHARGES: How to Save $$$ on Your Phone Bill. We have taken our message on phone issues to the people all across the United States, on national media (Donahue, Mike Douglas) and on radio and TV talk shows in markets large and small.

NCCB has been the primary consumer advocate on national telecommunications issues before the Federal Communications Commission. Some highlights:

*NCCB asked the FCC to return to consumers $100 million in revenues taken in by AT&T in 1978, revenues that exceeded the company's allowable rate of return on investment (CC Docket No. 79-187).

*NCCB challenged the FCC to revise its ratemaking formulas to better reflect the costs of providing long-distance service, and to remove unwarranted costs from rates paid by off-peak users (CC Docket No. 79-63).

- *NCCB recommended that the Commission require AT&T to revise its WATS tariff to more accurately reflect pricing differentials by time-of-day, and the Commission ordered such changes on the grounds offered by NCCB (CC Docket No. 80-765).
- *NCCB has asked the FCC to give consumers deeper night/weekend discounts on MTS service, thus providing off-peak users with proper price signals and encouraging more efficient use of the phone network (CC Docket No. 81-415).

NCCB has met frequently with representatives of government and industry to present the consumers' case for a competitive marketplace, improved service, and reasonable rates. NCCB participated in the Ad Hoc Government/Consumer Working Group on Usage Sensitive Pricing (National Telecommunications and Information Administration, 1980-81). NCCB traveled to California to assist local ratepayers in protecting their rights to local exchange service adequate to their needs. NCCB has accepted invitations to address the communications subcommittees of both the House and the Senate on user needs and consumer rights in telecommunications.

Through a combination of publishing, public appearances, litigation and lobbying, NCCB has taken the lead in helping consumers through the transition in the telecommunications marketplace, and in assuring that consumers' rights are protected during these times of upheaval.

The Consent Decree

While the proposed settlement of the Government's antitrust suit against AT&T appears to represent a significant positive step toward increased competition in the telecommunications field, NCCB is deeply concerned that the plan is so deeply flawed that its implementation would not be in the public interest.

Accordingly, it is our intention to urge Judge Harold Greene not to approve the consent decree as drafted. Moreover, we doubt seriously that it will be possible for the Judge to convince the parties to agree to those changes which in our view are necessary to make the proposed order acceptable. Consequently, we believe that legislation addressing the restructuring of the telecommunications industry is more urgent today than ever.

Our concerns go both to the procedures and substance of the proposed settlement. Foremost among our concerns is the degree to which the consent decree leaves the entire divestiture in the hands of AT&T. The provisions of the agreement, in fact, are so one-sided, that it is difficult to believe that the Justice Department did more than dot a few "i's," cross a few "t's" and sign on the dotted line.

Among our concerns over procedure are the following: (1) Under the agreement AT&T alone is given responsibility for devising the plan of divestiture; (2) There is no provision for court review or public comment on the detailed plan of divestiture; (3) The timing of the implementation is fully within the control of AT&T, and is so short as to create doubt that the Justice Department will be given adequate opportunity to review the divestiture plan; (4) There is no provision for consumer or user input in the planning or implementation of the divestiture.

Once the court approves the agreement, court and public oversight of the divestiture process almost vanishes. AT&T alone is given the authority to devise the plan and resolve issues of essential importance both as to the goals of the suit and as to the interest of the end user.

How many operating companies will be created? How will assets be evaluated for the purpose of the divestiture? How will customer premises equipment be valued? Will consumers who already have invested hundreds of dollars in rental fees be entitled to keep their equipment, or must it be transferred to Bell? Should Bell be required to sell the equipment to the consumer at its net book value? Of course, these are only a few of the hundreds of issues left within AT&T's discretion resolve, with the Justice Department to "approve" the plan following some indeterminate level of review. It is our view that the Justice Department is not the appropriate authority to make such a review. The subject matter of these issues is outside the scope of experience and expertise of the Justice Department. It would be far superior to have FCC reveiw, or court review, concurrent with the Department of Justice. Further, since the success of the divestiture plan is contingent on how AT&T chooses to resolve the numerous issues left to its discretion, public comment upon the plan prior to its implementation seems to be both prudent and sound public policy.

TUNNEY ACT REVIEW

The proposed consent decree will not go into effect until approved by Judge Greene. Under the procedures which the parties have chosen, the provisions of the Tunney Act, 15 U.S.C. 16 et. seq. will apply. Under these procedures, the Justice Department will file a competitive impact statement, AT&T will disclose its government contracts, and--most importantly--there will be a 60-day period for the public to submit comments to the Attorney General about the proposed agreement.

While we fully support the Tunney Act review process, we believe that the residential and small business end users will not be adequately represented during this process. Consequently, NCCB, along with the Consumer Federation of America, Congress Watch and other groups are filing this Friday a petition with Judge Greene seeking to have him appoint a consumer expert. The expert will then advise the court on whether and under what circumstances the settlement should be accepted, from the point of view of the residential end user.

The Tunney Act specifically authorizes the court in these cases to obtain the services of "outside consultants" and "expert witnesses" to assist in evaluation of consent agreements. We believe that a consumer consultant, given adequate resources, will be able to provide Judge Greene with sufficient data and information to permit him to satisfactorily determine that whatever decision he ultimately makes will be in the best interest of the end user.

There will be a number of groups representing consumers that will file comments with Judge Greene during the 60-day comment period. Groups such as NCCB, Consumer Federation of America and others, however, neither have the expertise nor the resources required to participate in the zealous and aggressive manner required. Presumably, a court-appointed expert could bring such expertise and resources to bear in the matter. NCCB will provide in its motion to the court the names of five to seven experts in the telecommunications field who have consented to be considered by Judge Greene for appointment as the court's expert.

Historically, residential consumers have been underrepresented in common-carrier telecommunications issues. There is not the sophisticated consumer's telephone advocacy community similar to that which has developed over the past decade in, for example, the energy field.

Indeed, the proposed consent decree may well be the equivalent of the early Seventies OPEC oil embargo in terms of its consumer impact. The need for Judge Greene to appoint a consumer expert who will have the authority to obtain the services of a variety of other experts as needed is essential, in our view, to a fair and complete evaluation of the proposed agreement is likely to have catastrophic consequences for industry competition or for ratepayers.

CONSUMER IMPACT

It is difficult without the benefit of the expert analysis that we believe the settlement agreement requires, to fully predict the consequences for residential telephone consumers. What we can do is outline a number of areas of deep concern that seem obvious from our review of the consent decree thus far:

Bell Laboratories

The proposed order fails to consider the legitimate interest of the local operating companies and their customers in Bell Laboratories. Under the proposed settlement, patents and technology developed with ratepayer funds will be the sole property of AT&T. Although there is a transition period during which Western Electric and Bell Laboratories must provide "research, development, manufacturing, and other support services" to enable the Bell operating companies (BOC's) to fulfill their functions, there is no requirement that ratepayers be compensated for the patents and technology AT&T receives under the proposed divestiture. The net result is that consumers may actually be severely penalized once when they lose to AT&T that for which they have already paid, and again when they pay to develop or lease the same or similar technology for the newly independent BOC's.

Consumers pay for Bell Laboratory research in two ways. The first way is through the license contract, which transfers approximately 2% of operating company revenues to the parent company. The second way is through the price of equipment purchased from Western Electric. Yet, under the proposed plan, there is no provision whatsoever that the research or the patents developed with these funds be licensed back to the operating companies, or that the operating companies be compensated, or that some arrangement be made whereby the operating companies are permitted to share in the revenues generated by the exploitation of these patents or inventions.

At a minimum, we believe it is essential that AT&T be required to disclose the work in progress, developed with ratepayer funds, which is for or related to local operating exchange services. Without such disclosure it is impossible to know exactly what the consumer is being asked to give up.

Ever since the announcement of this proposed divestiture agreement, I have wondered why AT&T suddenly (or so it seems) changed its position and agreed to divestiture. I have had a dream that late one night, about a month or so ago, a bright young scientist ensconced deep in the bowels of Bell Labs had a vision, and as a result years of work fell into place. With great excitement, the scientist fired a brief missive to Chairman Charles Brown: "Charlie, we got it, let's go for it." What "it" is, I don't know, but I can imagine that it might be the invention of the decade, or century, which will obsolete the entire operating company system, and put AT&T back into control of "the system." Without disclosure by Bell, how can we be sure there isn't such technology waiting for the "right time" to be disclosed?

Operating Revenues

The division of responsibilities between AT&T and the operating companies raises serious concerns as to how AT&T can assure the financial viability of the operating companies without forcing local exchange rates to skyrocket. Already, serious concerns have been raised by various parties about the loss of revenues faced by the operating companies from transfer to AT&T of the Yellow Pages and customer premises equipment.

Further, there is a major controversy concerning the amount of revenues that will be lost as the result of the elimination of a cross-subsidy from long-distance to local exchange service. If one believes AT&T, long-distance revenues have for years significantly subsidized local rates. It was the alleged existence of this cross-subsidy, for example, that AT&T historically used as the basis for asserting that competition in the long distance markets was unfair to it and would be poor public policy.

As reported as recently as last November, Chairman Charles Brown was reported in the Washington Post to have said that because of competition and the elimination of local service subsidies over the next five years to a decade, local rates would have to double or triple. Yet, when confronted with the flash-cut occasioned by the divestiture, which seems to dictate an immediate end to this cross-subsidy, Chairman Brown testifies that local rates will only increase at a "normal" rate of five to eight percent a year, a rise which he says would have occured in any case.

On the other side of the cross-subsidy controversy is William McGowan, Chairman of MCI Communications. Mr. McGowan denies the existence of any such cross-subsidy. At the recent Consumer Assembly of the Consumer Federation of America, Mr. McGowan urged consumers to "challenge Bell's underlying claim that you are getting a free ride on local service. If you don't, you will pay into the hands of their attempt to brainwash the American people into expecting huge local rate increases as a matter of course. Those claims can be challenged, because they are found on the sand of improper cost allocations, double counting, and insufficient information."

It is clear at this point that there is a potential for tremendous consumer cost impact through higher rates as the result of the proposed divestiture. There is the potential for loss of major revenue sources to local operating companies. That loss must be made up from the one source of revenue left to them under the consent decree--local exchange service. This threat of impending rate hikes combined with conflicting claims of various interested parties demonstrates clearly the urgent need for Judge Greene to appoint an expert to advise him on how best to protect the interests of the residential and small business consumers in the implementation of this consent decree. It is vital that Judge Greene be fully informed of consumer impact when he decides whether the implementation of this decree is in the best interest of residential and small business end users.

Operating Company Structure

One of the most serious flaws in the consent decree is the degree to which AT&T is given control over devising the plan for divestiture, including the decision on the number and structure of the operating companies to be created. It is our view that the short and long-term interests of the operating companies in the divestiture process are not necessarily identical to the interests of AT&T, and therefore, a somewhat adversarial relationship ought to exist as the divestiture plan is developed. The consent decree, however, assumes an identity of purpose and organization within AT&T, and further assumes AT&T can fairly decide what is in its best interest and in the best interest of the new companies that will be created.

We believe Judge Greene should require the creation of an entity to represent the operating companies in the divestiture process. It could be composed of representatives of the operating companies, representatives of state regulatory commissions, and/or consumer or public counsels. AT&T argues that concern about protecting the best interest of the operating companies is unfounded, and based on a lack of appreciation of the power position that operating companies occupy in the Bell System. But even assuming that the companies do occupy a special position, the fact remains that AT&T has the legal authority to make the final decisions in the matter. Moreover, the incentives for local operating company executives to take strong, independent stands is greatly diminished so long as the question of whether employees will "stay" or "go" is left open.

Put bluntly, we are concerned that officers of the operating companies will probably want to stay with AT&T, rather than with the operating companies, and therefore they will have some incentive to not represent the interests of the operating companies aggressively during the divestiture process. The thought is that these "team players" would be rewarded with new positions in AT&T.

Competition

The measure of the value of the consent decree and the divestiture of the local operating companies will be how well the goal of increased competition in the various telecommunications industries is achieved, and how consumers are benefited. Short-term reasonable cost increases to consumers might well be justified by increasing competition, new and better service choices, and lower prices in the long term. The question is whether the settlement agreement is likely to achieve these goals.

The agreement does bode well for enhancing competition in the long-distance phone service market. The public stands to benefit from the requirement that the operating companies provide equal and fair access to the local exchange for competing long-distance providers. The proposed consent decree should at long last end the history of discrimination by AT&T against carriers attempting to compete with its Long Lines Division. We believe that consumers will be better off by having the right to choose from among competitive long-distance services.

We are less sanguine, however, about the impact of the proposed divestiture upon the terminal equipment and customer premises equipment (CPE) markets. The requirement that equipment be purchased without discrimination from competing sources is helpful. However, the goals of this divestiture would not likely be achieved if only one or two operating companies were to emerge from the divestiture. We are pleased that AT&T has indicated that its current thinking is to prefer the creation of seven or eight regional companies, as this could open up CPE competition more widely. However, we are concerned that it is AT&T, and not an entity representing the independent interests of the operating companies, making this decision.

Further, whether there will be increased competition in the CPE market may well depend on how the equipment already in place is treated. If the equipment essentially stays in place, and there is merely a change in "title" from the operating companies to Western Electric or AT&T, relatively little has been done to enhance competition. On the other hand, it would be unfair to force consumers to give up their existing equipment and to choose between various competitors for their home telephone sets. Similarly, it seems unfair to allow AT&T to purchase the equipment from the local operating companies at what is likely to be an attractive, depreciated price, without first offering the residential consumer with the right to purchase the set. Since a sale or transfer must take place in any case, it is our view that consumers should be given the option to purchase the equipment now in their homes for a price that approximates net book value, or equal to what AT&T proposes to pay for such equipment.

Although the proposed divestiture will eliminate the ability of AT&T to subsidize its competitive long-distance operations with monopoly local exchange revenues, problems of cross-subsidization will remain. This is so because AT&T, through its Western Electric subsidiary and Long Lines Division, will continue to be the major force in both equipment manufacture and domestic intercity telecommunications. This dual involvement allows for cross-subsidization between the two services, and thus artificial manipulation of the cost of phone equipment and long-distance service. Such manipulation, if combined with a predatory pricing policy, could drive competition from the marketplace and result in higher costs for consumers.

Therefore, we support a continued requirement that all AT&T unregulated services be offered through one or more fully-separated subsidiaries, not unlike those called for in Rep. Timothy Wirth's bill H.R. 5158, the proposed Telecommunications Act of 1981.

Consumer Representation

Congress and the courts have struggled with the issue of the appropriate structure for the telecommunications industry almost from its inception. The last great effort at restructuring the phone industry concluded with the 1956 consent decree. Whether the 1982 consent decree will be any more successful than its predecessors is difficult to tell, although there is some cause for optimism in the terms of the settlement agreement.

As we go about the business of restructuring the telecommunications industry, we should also take this opportunity to provide for the establishment of a structure to enable consumers to organize and effectively represent themselves. As a result of this consent decree, it is likely that there will be created a number of large regional operating companies with monopoly control over local exchange service. Nationally, AT&T will continue its monopoly position in the long-distance marketplace for the foreseeable future. At the same time, a new era of competition looms, placing corporate giants such as IBM and Exxon in competition with AT&T. In this brave new world of deregulated competition and large regional monopolies, we think there must be a large, effective organization dedicated to the representation of the interests of residential telephone users. Such an organization could represent consumer interests in state and federal ratemakings and other proceedings, and could also serve as a consumer monitor on the telecommunications industry for Congress, the courts, and the regulators.

Just this week, Rep. Ronald Mottl introduced legislation which, if enacted, will accomplish the goal of assuring effective consumer participation in the rapidly-changing communications environment. The National Telecommunications Consumers Board Act provides that exchange and interexchange carriers must include notices with their bills inviting residential telephone consumers to join an organization which would, in turn, represent them before rate-setting and other governmental bodies. Any residential telephone consumer, 16 years of age or older, would be able to join the organization by paying an annual membership fee. Membership would be voluntary and would entitle each individual member to vote for the Board of Directors. Membership funds would be used to hire a staff, including attorneys, economists, and other consumer experts, to carry out the purposes of the organization.

Allowing consumers to organize in this manner is both efficient and inexpensive. It creates no governmental bureaucracy, and since the consumer organization must pay for the printing of the membership invitations (and for any reasonable costs that exchange or interexchange carriers incur in enclosing or mailing them), there is no cost to the taxpayer or to the phone company. Best of all, the organization gives a large number of consumers a way to communicate with one another and to raise the funds necessary for effective and responsible representation of their telecommunications concerns.

A similar organization has already been proved successful on a statewide level in Wisconsin. Since 1979, Wisconsin has had a Citizens Utility Board (CUB) representing residential utility consumers. Citizens are invited to join through enclosures in their monthly utility billings. To date, Wisconsin CUB has over 50,000 members and has helped save over $14,000,000 for utility users.

So long as the process of restructuring the telecommunications industry remained with the Congress, it was possible to obtain consideration in an integrated policy-making setting of our proposal and others which seek to assure effective consumer representation. (Indeed, H.R. 5158 has specific provisions for funding of consumer representation.) If, however, the sole industry restructuring effort is destined to take place in the judicial forum, the unique opportunity to assure institutionalization of consumer representation may be lost forever.

Consequently, we believe that Judge Greene should consider requiring the establishment of a National Telecommunications Consumers Board as part of the proposed settlement. The purpose of the antitrust suit against AT&T is to promote the interests of phone users, and the Consumers Board idea affirmatively fosters that purpose. Such an organization would serve a significant prophylactic role by assuring that there is an effective entity to pursue private antitrust remedies on behalf of the general public, and to report to Congress on a periodic basis on the state of competition in the industry.

Conclusion

In conclusion, Mr. Chairman, it is clear that meaningful legislation will be needed to ensure that there will be full consideration and protection of the consumers' interest as the process of restructuring the telecommunications industry wears on. We want to emphasize that we strongly support the principle of divestiture of the operating companies. What we object to is the seemingly haphazard fashion in which the Justice Department apparently entered into this agreement. Further, we believe that additional consideration must be given to divestiture by Bell of some or all of Western Electric and Bell Laboratories.

Throughout this process, it is crucial that informed citizen participation be permitted and encouraged. We urge Judge Greene to appoint a consumer expert to assist him in the evaluation of the proposed consent decree. We also urge him to require that there be meaningful consumer participation and public review of the plan of divestiture ultimately proposed by Bell. Finally, we urge him to require that the settlement include a provision to give consumers access to the billing systems of these carriers for the purpose of organizing themselves into an effective consumer organization serving as the eyes and ears of the residential phone consumer in the years to come.

Thank you.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. AMERICAN TELEPHONE AND TELEGRAPH COMPANY; WESTERN ELECTRIC COMPANY, INC.; AND BELL TELEPHONE LABORATORIES, INC., Defendants.	)	Civil Action No. 74-1698

MOTION OF NATIONAL CITIZENS COMMITTEE FOR BROADCASTING, PUBLIC CITIZEN, CONSUMER FEDERATION OF AMERICA, REPRESENTATIVE RONALD MOTTL, MEDIA ACCESS PROJECT, AND THE CONSUMER UTILITY BOARD OF WISCONSIN FOR THE APPOINTMENT OF AN EXPERT WITNESS

National Citizens Committee for Broadcasting, Public Citizen, Consumer Federation of America, Representative Ronald Mottl, the Media Access Project, and the Consumer Utility Board of Wisconsin hereby move the Court, pursuant to 15 U.S.C. §§ 16(f)(1) & (2), and the Court's Order of January 21, 1982, for the appointment of an independent expert to advise the Court on the implications of the proposed settlement of this action on residential and small business telecommunications users. In support of this motion, applicants submit herewith a memorandum of points and authorities and a proposed order.

Respectfully submitted,

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Attorneys for Applicants
for Intervention

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.) Civil Action No. 74-1698
)
AMERICAN TELEPHONE AND TELEGRAPH)
COMPANY; WESTERN ELECTRIC)
COMPANY, INC.; AND BELL TELEPHONE)
LABORATORIES, INC.,)
)
Defendants.)

ORDER

Upon consideration of the motion for appointment of an independent expert to advise the Court on the likely effects of the settlement of this action on residential and small business users of telecommunications services filed by the National Citizens Committee for Broadcasting, Public Citizen, Consumer Federation of America, Representative Ronald Mottl, the Media Access Project, and the Citizens Utility Board of Wisconsin ("applicants for intervention"), the memoranda submitted in support thereof and in opposition thereto, and the entire record herein, it is this _____ day of February, 1982 hereby

ORDERED that applicants' motion is hereby granted; and it is further

ORDERED that the Court will select an expert to advise it on the likely effects of the settlement in this action on residential and small business users of telecommunications services as soon as practicable. In the event any person has suggestions as to who should be appointed, such suggestions should be filed with the Court within ten days of this Order.

UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. AMERICAN TELEPHONE AND TELEGRAPH COMPANY; WESTERN ELECTRIC COMPANY, INC.; AND BELL TELEPHONE LABORATORIES, INC., Defendants.	)	Civil Action No. 74-1698

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THE MOTION OF NATIONAL CITIZENS COMMITTEE FOR BROADCASTING, PUBLIC CITIZEN, CONSUMER FEDERATION OF AMERICA, REPRESENTATIVE RONALD MOTTL, MEDIA ACCESS PROJECT, AND THE CITIZENS UTILITY BOARD OF WISCONSIN FOR THE APPOINTMENT OF AN EXPERT WITNESS

This memorandum is submitted in support of the motion by National Citizens Committee for Broadcasting, Public Citizen, Consumer Federation of America, Representative Ronald Mottl, the Media Access Project, and the Consumer Utility Board of Wisconsin ("applicants for intervention") for the appointment of an independent expert to advise the Court on the likely effects of the proposed settlement of this action on residential and small business users of telecommunications services. Applicants seek the appointment of an independent expert because the settlement of this action will doubtless have profound effects on their interests, and because neither of the existing parties to this action adequately represents them.

AN INDEPENDENT EXPERT SHOULD BE APPOINTED TO ADVISE THE COURT ON THE LIKELY IMPACT OF THE PROPOSED SETTLEMENT ON RESIDENTIAL AND SMALL BUSINESS USERS OF TELECOMMUNICATIONS SERVICES

In its Order of January 21st, this Court emphasized that it did not intend to enter the proposed final judgment in this action until the Court determined that the proposed settlement is "in the public interest." The settlement of this action will have a far-reaching impact; indeed, no one in this country will go untouched by this settlement. Yet despite the settlement's wide ranging impact, the interests of a vast segment of the telecommunications market -- the residential and small business user -- are not represented before this Court. Moreover, since this segment of the market is so diffuse and amorphous, it is unlikely residential and small business users will be able to produce the sort of informed analysis of the proposed settlement which would assist the Court in assessing whether the proposed decree treats them fairly.

This problem is compounded by the enormous expense which would necessarily attend retaining an economist and perhaps other experts to study and analyze the proposed decree from their perspective. Given the relatively minor economic interest of each individual residential and small business user, particularly when contrasted to the economic interests of major users, it is highly unlikely that residential and small business users will be able to afford the sort of highly techinical assistance needed to advocate their interests effectively, even though collectively their interests plainly overshadow those of even the larger corporate users. Indeed, applicants are filing this motion precisely because their limited budgets do not permit them to retain the services of an expert economist.

Accordingly, applicants ask this Court to appoint an independent expert to advise the Court on the likely effects of the proposed settlement on the residential and small business user.[1] Undoubtedly, major users will have the proposed decree analyzed from their perspective. Without the appointment of a consumer expert, however, it is likely that the interests of the residential and small business user will be effectively unrepresented. Given the fact that many of the provisions of the proposed decree appear to affect adversely certain residential and small business users, it is critical to have the decree assessed from their point of view.

Applicants envision this expert as acting almost as an ombudsmen for those telecommunications users whose economic stake in the ultimate outcome of this action is too confined to justify their retaining their own expert. The court-appointed expert would advise the Court on the issues about the adequacy of the settlement which bear directly on the economic interests of this segment of the market.

For example, perhaps the most hotly debated issue generated by the proposed settlement is whether the proposed divestiture of the twenty-two local Bell operating companies will result in higher local exchange telephone rates in certain parts of the country. Indeed, Congressman Wirth, Chairman of the House Subcommittee on Telecommunications, has already taken the position that, absent legislation, the proposed decree will have serious effects on the rate structure in rural areas. Even AT&T has expressed inconsistent positions with respect to the effect on rates. While first speculating that rates would rise sharply as a result of the settlement, AT&T now claims that rate increases will be unaffected by divestiture. At the very least, an independent assessment of the likely effects that the settlement will have on the rates charged to residential and small business users should be available to the Court. Yet without a court-appointed expert, there is no guarentee that the Court will have this critically important information when it makes its "public interest" determination.

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[1] In light of the enormous complexity of the issues posed by this settlement, it may well turn out that the Court will need to appoint several experts to advise it on the various aspects of the proposed settlement. Applicants submit that at the minimum, however, at least one consumer expert should be appointed.

Another question of particular concern to consumers is the fate of Bell Laboratories. Bell Laboratories is one of the most sophisticated research and development institutes in the United States. It was built with rate-payer funds, and rate-payers have invested heavily in the research Bell Laboratories has been conducting. Nonetheless, the proposed settlement appears to contain no requirement that any of the research presently in progress be licensed or otherwise provided to the newly-divested operating companies without cost, or at least at favorable rates. As a result, consumers who have already paid for ongoing reseach may well be saddled with paying for it again when the Bell operating companies ultimately contract with Bell Laboratories to purchase the research. This, too, is an issue which warrants expert evaluation.

A third concern is simply one of oversight. The proposed settlement is little more than a blue-print. The decisions on how to implement the settlement -- which the decree leaves largely to AT&T -- will vitally affect consumers. An expert appointed to advise the Court could play an important role in scrutinizing the decisions of AT&T in implementing the decree to ensure that the interests of the ultimate rate-payer are fully protected. This need is particularly compelling in light of the inherent limitations of the Antitrust Procedures and Penalties Act. While it is true that the public will be permitted to comment on whether the proposed decree should be entered, the public's right of participation extends no further. Thus, a year down the road when critical questions arise concerning, for example, the valuation of the equipment AT&T will ultimately "buy back" from the Bell operating companies, there is no procedural device for securing public comment. Yet these questions are every bit as important to consumers as are the questions concerning the structure of the decree itself.

For these reasons, applicants urge the Court to appoint at least one expert to serve in the role of an adviser from the perspective of the interests of the residential and small business user. In the event the Court agrees to appoint such an expert, applicants have attached to this memorandum the resumes of several leading experts in the field of telecommunications. Each of these experts has been consulted and is willing to be considered by the Court.

CONCLUSION

For the foregoing reasons, the Court should permit applicants to intervene and should appoint an expert to advise the Court on the effects of the decree on the residential and small business user.

Respectfully submitted,

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February 8, 1982

STATEMENT OF ROBERT E. BENNIS

Mr. BENNIS. My name is Bob Bennis and I am manager of communications systems at Westinghouse Electric Corp. However, for the purpose of my testimony today, the prepared as well as my comments on my testimony, I represent the International Communications Association, which is a large user group made up of over 500 companies who in effect are the major purchasers of the kinds of services and equipment represented by the Bell System, by the MC's, by Satellite Business Systems, and the other kinds of suppliers of telecommunications services to the tune of about $15 billion a year. So my statements and my comments will reflect the perspective of this very, very specialized group of users.

Now, I will just highlight three or four of the concerns that are fairly well detailed in the summary that I presented to you, the written statement. And this addresses primarily and specifically the settlement decree as it is understood by the users in our association.

First of all, we are uncertain as to the status of terminal equipment and inside wiring, not a very sexy kind of a concept, but it is an important and essential ingredient of our business. We have tens of thousands of telephone systems without which we cannot operate. We have hundreds of miles of wires within the buildings connecting these systems. In most cases the equipment and wiring is furnished by the Bell System. Not in all cases, but in most cases. We are very concerned about how we go from here, where we lease this equipment in most cases, where we may have to buy it, where it may be provided by a new entity, where we do not know what the price will be or the terms and conditions under which we obtain it. So it is a very real concern, and it is something that the settlement does not discuss in really sufficient detail to give us a handle as to what is going to happen.

Second, there is no provision in the settlement for the interconnection of private systems. Most of the companies that I represent have private telephone systems and/or private networks which must in order to be viable be able to interconnect with the existing systems of the suppliers we have been talking about to which the settlement addresses itself. It represents a large investment. We put them in on the basis of being permitted to interconnect under the present ground rules, and unless that issue is addressed very specifically, I could see these kinds of investments being made completely inoperative.

Mr. SCHEUER. Completely what?

Mr. BENNIS. Inoperative. We are not able to operate into these networks. They have to interconnect with the Bell System or the SBS's, the MCI's, and all the other suppliers out there.

A third major area that we are concerned about is the question of access charges. The authority to change from a separations procedure, which is the basis by which the operating companies obtain a good deal of their revenue, to an access charge on a conceptual basis is no problem. We have no problem with that. We do see some problems, however, in that as we understand the settlement some 50 public utility commissions as well as the FCC could possibly have jurisdiction over the imposition and the establishment of rates for these access line charges, and this could be a very difficult area for us to administer.

Finally, in the matter of A.T. & T. providing essentially all toll service, both intrastate and interstate, we see a possibility here for some potential for cross-subsidy. Today we know as users that where A.T. & T. has the monopoly for short-haul rates, short-haul services within the State and between metropolitan areas, we have seen an enormous increase in those prices without a corresponding increase or in some cases even a decrease in the long-haul rates where there is competition. So in those four areas I think it is extremely important that the final settlement address more specifically than it has to date answers to those questions.

Thank you very much.

[Mr. Bennis' prepared statement and attachment follows:]

STATEMENT

OF

ROBERT E. BENNIS
MANAGER COMMUNICATIONS SYSTEMS
WESTINGHOUSE ELECTRIC CORPORATION

ON BEHALF OF THE

INTERNATIONAL COMMUNICATIONS ASSOCIATION
(ICA)

Mr. Chairman and members of the Subcommittee on Telecommunications, Consumer Protection, and Finance, my name is Robert E. Bennis and I am Manager of Communications Systems at Westinghouse Electric Corporation, and I am pleased to have been invited to testify on the proposed settelement of the AT&T case on behalf of the International Communications Association (ICA) in my capacity as Chairman of the Communications Regulatory Liaison Committee of the ICA.

You and the members of your subcommittee are to be commended for holding these additional hearings on the proposed settlement. As you know, the ICA sent you a letter on January 13, 1982, requesting that the proposed settlement be "throughly explored in a deliberative fashion . . . . before proceeding with any consideration of legislation." We also understand that a similar request was made by Congressmen Luken and Scheuer of this subcommittee. These hearings should help us reach a better understanding of this significant event.

THE INTERNATIONAL COMMUNICATIONS ASSOCIATION

The ICA is the largest and most broadly-based organization of telecommunications users in the United States. The ICA represents large corporate, governmental, and educational users of telecommunications services and equipment whose yearly individual expenditures in this area are over $1 million. The ICA, whose approximately 550 members spend collectively over $15 billion on telecommunications, is recognized by industry and government alike as the preeminent organization of its kind. It exists for the advancement of professional and scientific knowledge in the telecommunications field. Typically, ICA members have large intercity voice and data transmission networks. Entities which are predominately engaged in the production, sale, or rental of telecommunications services or equipment are excluded from membership in the ICA.

THE PROPOSED SETTLEMENT

Background:

With the development of various voice and data based systems and applications, large users have become dependent on efficient, reliable, readily available, and reasonably priced telecommunications equipment, facilities, and services. For this reason, the ICA is most interested in what has to be the single most significant event in the telecommunications industry since the Carterphone decision. The proposed settlement will test the abilities of our membership to manage their telecommunications operations during a period of change which is extremely difficult to perceive at this time. In this light, the ICA has reviewed the proposed settlement to determine its effects on telecommunications users.

While the proposed settlement represents a significant effort to resolve some of the major policy problems facing the telecommunications industry, it gives rise to a number of serious concerns for users, such as ICA members. The ICA has prepared a list of concerns which are attached as Exhibit A. I will elaborate on several of these concerns.

Concerns:

1. The ICA is uncertain whether in-place terminal equipment would continue to remain under regulation as provided for in the FCC's Computer II decision. Without continuing regulation for some reasonable period of time, users have no assurance that such terminal equipment and inside wiring would remain available at reasonable rates, terms, and conditions. Since the ratepayer has been paying for his in-place terminal equipment and inside wiring through ratepayer leases with the Bell Operating Companies (BOC's), we are also of the opinion that the ratepayer should have the first option to purchase any in-place terminal equipment and inside wiring before it is transferred to AT&T or deregulated.

Flash-cut deregulation of all such equipment and inside wiring leaves users in a potentially precarious situation. No guarantees exist that older equipment would continue to be offered and/or maintained, or that if continued to be offered, that the rates would be the same as they are today under tariffs and/or contracts. The transfer of inside wiring to AT&T provides it with a unique edge when competing for the replacement of existing telecommunications systems.

2. The proposed settlement makes no provision for the interconnection of privately-owned telecommunications systems to the local exchange facilities of the Bell Operating Companies. Only interconnection to BOC's local exchange service by interexchange common carriers and information service providers is specified.

The potential for discrimination against interconnection of interexchange and intraexchange privately-owned systems and intraexchange common carriers and information service providers seems contrary to the efforts to stimulate competition and may not be intended by the parties to the proposed settlement.

3. The proposed settlement creates a system of access charges which replaces the existing separations procedures for the division of toll revenues between intrastate and interstate carriers. It is uncertain whether the parties to the proposed settlement have the authority to replace the existing procedures. In addition, since both the FCC and the 50 public utility commissions would apparently have jurisdiction over the establishment of access charges (depending whether access was for an interstate or intrastate service), there would be the potential for unnecessarily wide variation in the price of access.

4. The settlement proposes that all toll service will be provided by AT&T. This includes the long-haul, intercity type of service which other common carriers (OCC's) may now or potentially offer. Also, this includes short-haul rural and metropolitan area toll routes for which no competition exists or is likely to emerge in the near future. It is conceivable that AT&T could engage in cross-subsidization of its competitive long-haul intercity services with its monopoly short-haul routes, and therefore have an unfair advantage over the OCC's.

* * *

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to express the concerns of users. I hope the views of the ICA will be of assistance in your important deliberations of the proposed settlement, and I am prepared to answer any of your questions on the users' perspective on the proposed settlement at the appropriate time.

EXHIBIT A 2/3/82

KEY ICA CONCERNS WITH AT&T ANTITRUST CASE SETTLEMENT

The International Communications Association (ICA) has reviewed the recently proposed Settlement of the antitrust case, U.S. v. AT&T. While this Settlement represents a significant effort to resolve some of the major policy problems facing the telecommunications industry, it gives rise to a number of serious concerns for users, such as ICA member companies.

1. CONTINUED REGULATION OF BELL'S IN-PLACE TERMINAL EQUIPMENT IS UNCERTAIN

The proposed Settlement makes it uncertain whether the Bell system's in-place customer terminal equipment and inside wiring would continue to remain under regulation as provided for in the FCC's Computer Inquiry II decision. The Bell system controls approximately 80% of in-place terminal equipment in its operating territories. Without continuing regulation for some reasonable period of time, users would have no assurance that such in-place terminal equipment and inside wiring would remain available at reasonable rates, terms, and conditions. In addition, users should be able to purchase any in-place terminal equipment or inside wiring before it is transferred to AT&T or before regulation ceases.

2. VIABILITY OF FUTURE BOC'S IN DOUBT

Under the proposed Settlement, the present Bell Operating Companies (BOC's) would be divested from AT&T, and they would be required to transfer to AT&T the ownership of and responsibility for all terminal equipment, intrastate interexchange services (toll, private line, and WATS), and the "Yellow Pages". The former BOC's would thereafter be restricted to providing only local exchange and local exchange access services under regulation. As a result, there is doubt as to whether the former BOC's will be able to attract necessary capital and revenues to both maintain existing service levels and offer the necessary technological innovation in the future. The restrictions on service offerings by the BOC's may be extreme.

3. INCREASES IN LOCAL EXCHANGE RATES POSSIBLE

A number of sources, including some Bell system operating company officials, have predicted that the proposed Settlement will accelerate the increases in local exchange rates. If this should occur, business users could well receive very substantial increases above the increasingly higher rates they are already paying for local exchange service.

4. UNCERTAINTY OVER ACCESS CHARGES

The proposed Settlement creates a system of access charges which replaces the existing separations procedures for the division of toll revenues between intrastate and interstate carriers. It is uncertain whether the parties to the proposed Settlement have the authority to replace the existing procedures. In addition, since both the FCC and the 50 public utility commissions would apparently have jurisdiction over the establishment of access charges (depending whether access was for an interstate or intrastate service), there would be the potential for unnecessarily wide variation in the price of access.

5. FUTURE STATUS OF SOME SERVICES (CENTREX, CCSA, EPSCS, ETN, ETC.) IS UNCERTAIN

Because of the division of present BOC responsibilities under the proposed Settlement, the future status of certain widely-used "mixed" services like Centrex, CCSA, EPSCS, and ETN is uncertain. These services are a combination of local exchange, terminal equipment, and interexchange functions which would be divided between AT&T and the former BOC's under the proposed Settlement.

6. SETTLEMENT LACKS PROVISION FOR ASSETS VALUATION AND ALLOCATION

The proposed Settlement does not provide guidance for establishing the rules for valuing and allocating the assets and debts of the BOC's. The BOC's assets and debt would have to be valued and then allocated to the plant and equipment that the BOC's and AT&T each will have under the Settlement after it would become effective. This issue is important to users because the future rates of both AT&T and the former BOC's will depend in considerable measure on their respective investments in plant and equipment.

7. NO PROVISION FOR PRIVATE SYSTEM ACCESS AND INTERCONNECTION OF EXCHANGE TELECOMMUNICATIONS

The proposed Settlement makes no clear provision for access by private interexchange telecommunications (such as private microwave systems) to the local exchange facilities of the BOC's. Only local exchange interconnection for interexchange common carriers and information service providers is specified in the proposed Settlement. Also, the proposed Settlement makes no clear provision for the interconnection of exchange telecommunications to the local exchange facilities of the BOC's. As a result, a large segment of telecommunications services (such as private interexchange telecommunications and exchange telecommunications) could be discriminated against under the proposed Settlement. This potential for discrimination should be corrected.

8. LACK OF OPPORTUNITY FOR PUBLIC COMMENT ON AT&T PLAN FOR IMPLEMENTATION OF PROPOSED SETTLEMENT

The proposed Settlement does not provide the opportunity for public comment on AT&T's, yet to be proposed, plan for implementation of the Settlement. As a result, the concerns of the type expressed in this paper may not be adequately considered or addressed with regard to that implementation plan. While there is opportunity for public comment on the Settlement there is no opportunity for comment on AT&T's implementation plan to be filed later.

Mr. SCHEUER. Thank you, Mr. Bennis.
Mr. Litke.

STATEMENT OF ROBERT M. LITKE

Mr. LITKE. Thank you, Mr. Chairman.

I will be as brief as possible. As a telephone user the city of New York is second only to the State in its costs. In 1981 our telecommunications bill exceeded $90 million.

Mr. SCHEUER. The city?

Mr. LITKE. City government, $90 million. Incidentally, that doubled over the last 5 years without an increase in volume. Almost 70 percent of our telecommunications costs are related to nontraffic-sensitive costs, 70,000 lines release, equipment, private line services, et cetera. Only 20 percent—excuse me—20 percent of our costs are for local calls and only 4.6 percent for long-distance calls and the remaining 5.8 percent for installation charges. So as a user our interests are really focused on what happens to the local operating company.

We are extremely concerned about the potential for rate increases on the local side as a result of the restructuring of the Bell System. We also are equally concerned with the possibility that the restructuring may diminish the quality of local service and produce rates that mitigate against the nearly universal availability of reasonably priced local telephone service.

Today the threat that we are concerned about is the unknown result of the antitrust settlement. With A.T. & T. forced to divest itself of its 22 operating companies, with A.T. & T. offering enhanced services and picking up the lucrative revenue sources, we are concerned that there is nothing left for the operating companies except the marginal potential for growth.

The position that is becoming clear to us is that the major loser under the restructuring plan will be the users of local telephone service, including cities such as New York City and our citizens, who have come to depend so heavily on reasonably priced basic exchange service. A.T. & T. chairman Charles L. Brown indicated that local rates will climb more than 10 percent a year during the next 5 years. That means we can look forward to local costs increasing more than 50 percent. We cannot ignore the impact of such a rate increase on the city of New York and on other users. Given the cutback in Federal funds to cities, we are finding it increasingly difficult to offer basic municipal services. The increase in telephone costs will only serve to exacerbate the situation. Additionally, the poor and the elderly residents of New York and other cities will find it difficult to pay for basic telephone service.

It is not just the anticipated increase in local telephone costs which is so alarming but the uncertainty regarding the future of the local operating costs. Stripped of their assets, deprived of the opportunity to enter the most lucrative sectors of the telecommunications industry, left without their Yellow Pages revenues and perhaps bereft of their most talented managerial personnel, the local operating companies cannot possibly offer the same quality of service which they now offer. Will we be paying more for service which declines in quality? Will the local operating companies become the railroads of the future?

Thank you, sir.

[Mr. Litke's prepared statement follows:]

STATEMENT OF ROBERT M. LITKE, COMMISSIONER
DEPARTMENT OF GENERAL SERVICES, THE CITY OF NEW YORK

Good afternoon Mr. Chairman and thank you for this opportunity to appear before you today. My name is Robert M. Litke. I am the Commissioner of the Department of General Services for the City of New York. As such, one of my responsibilities is to manage the telecommunications operations of the various agencies and offices of the City of New York.

The City of New York is the second largest user of telephone services in the State, second only to the State of New York. In 1981, our telecommunications expenditures exceeded $90 million. Almost seventy per cent of the City's telephone related expenses covered such non-traffic sensitive costs as the 70,000 lines which we get from the New York Telephone Company, monthly charges for standard telephone sets found in thousands of municipal offices around the City, charges for sophisticated switching systems, and costs for private lines leased from the telephone company which are used to transmit emergency messages to our Police and Fire Departments. Approximately 20 percent of our $90 million annual telephone bill is for local calling. The remainder of our telecommunications costs are for toll calls placed around the State and across the country (4.6 percent) and installation work charges (5.8 percent).

As a major user of the services provided by Bell's local operating company -- in this case the New York Telephone Company -- the City of New York and cities across the country have a vital stake in the restructuring of AT&T. We are extremely concerned about the potential for increases in local telephone rates which can result from the current proposal for restructuring the Bell System. Equally important, we view with alarm the possibility that the restructuring agreement may diminish the quality of local telephone service and produce rates that mitigate against the nearly universal availability of reasonably priced local telephone service.

Prior to the momentous developments of early January, Congress was considering important legislation which would chart the course of this nation's telecommunications industry for decades to come. While AT&T, its competitors in the field of long-distance services, and many others were scrambling to protect vested interests, it was this Committee -- and this Committee alone -- which sought to protect the interests of the public -- business customers, residential customers, and governmental customers of Bell. Through your efforts, the rights of small and large telephone users gained the national importance which it deserves.

But today there is the threat of the unknown facing the telephone user. A monumental anti-trust settlement has been reached in which AT&T -- the largest private corporation in the world -- has been "forced" to divest itself of its 22 Bell Operating Companies (BOCs) -- the companies which provide local telephone service to cities and states across the country. In exchange, AT&T no longer is banned from offering enhanced telecommunications services, its long distance services no longer are subject to stringent regulatory oversight, and AT&T has rid itself of its least profitable operations -- the BOCs -- while retaining its most lucrative sources of revenue, including the Yellow Pages. Under the settlement, the local Bell operating companies will be allowed to do nothing but provide local telephone service, a service with a marginal potential for growth. They are forbidden from engaging in competition with Bell or anyone else in the lucrative and growing terminal equipment market and in the high-technology information service industry.

The position that is becoming clear is that the major loser under the restructuring plan will be the users of local telephone service, including cities such as New York City and our citizens who have come to depend so heavily on reasonably priced basic exchange service. According to AT&T Chairman Charles L. Brown, local rates will climb more than ten percent a year during the next few years. This means, for example, that five years from now we can expect to pay over 50 percent more for telephone service than we currently pay. We cannot ignore the impact of such a rate increase on the City of New York and other users. Given the cutback in federal aid to the cities, we are finding it increasingly difficult to offer basic municipal services to our citizens. The increase in telephone costs will serve only to exacerbate this situation. Additionally, the poor and the elderly residents of New York and other cities will find it increasingly difficult to pay for basic telephone service.

It is not just the anticipated increase in local telephone costs which is so alarming but the uncertainty regarding the future of the local operating company. Stripped of their assets, deprived of the opportunity to enter the most lucrative sectors of the telecommunications industry, left without their Yellow Pages revenues, and even bereft of their most talented managerial personnel who will be attracted to AT&T, the local operating companies cannot possibly offer the same quality of service which they now offer. Will we be paying more for service which declines in quality? Will they become the railroads of the future?

Given the serious consequences for municipal governments and their citizens, we in the City of New York expect to consult with officials from other cities to determine what can be done to insure the viability of local telephone service at a reasonable price. We stand ready to work with Congress, and with this Committee in particular, to insure that the interests of users are fully protected.

Thank you for allowing me to appear before you today.

Mr. SCHEUER. I appreciate your testimony, Mr. Litke. You have repeated many of the concerns that we have expressed here on this side of the rostrum over the course of these hearings. I am going to ask you, I am going to ask the panel three or four questions, and then I ask you to respond as briefly as you can, because we have 11 or 12 minutes.

First of all, responding to the point you made early on, Mr. Litke, a point which we have met repeatedly up here, do you see any opportunity of ways that we can enhance the revenue potential of the local operating companies other than through increased interconnect charges?

Mr. LITKE. Yes, sir.

Mr. SCHEUER. Let me get my questions out so you all can be thinking about them. Second, what are the concerns that are raised by the pending settlement? What are the public policy issues raised by the pending settlement that we ought to address?

Specifically, are there any ways other than increasing the interconnect charges by which we can strengthen the local operating companies, and make them more robust and more able to provide an excellent quality of service at a minimum price? And fourth, what are the legislative issues that you think that we ought to be addressing right now, and what issues do you think can and perhaps we should wait on until we determine the final form and shape of the consent decree?

Mr. LITKE. I think I could be brief, because I have spent three hours listening and thinking. I think that local functions that clearly do not relate to the national fabric of A.T. & T., whether they are monopolistic or competitive, can be reserved for the BOC's. The Yellow Pages. There does not seem to be any structural reason why the New York Bell Telephone Co. could not operate the Yellow Pages and still be in a local monopolistic scenario. I think that the Congress has to establish the guidelines for the distribution of the assets, so that the lucrative money-making facilities or systems are not siphoned off, leaving the local companies with depreciated assets and a relative inability to raise money to do other things. And I think that the Congress has to figure out, that is your burden, not mine, fortunately, how to protect the basic ability of the BOC's to function, to raise capital, to maintain their management strengths, and to move into areas of potential revenue producing that we may not think of today.

There are many talented people in the New York Bell Telephone System that are walking around wondering whether they are going to A.T. & T. or going to be left behind. And these companies have to be strengthened in that negotiation process.

Mr. SCHEUER. Why should left behind be synonymous with being sent out to Canarsie? What is wrong with helping to run a major telephone system?

Mr. LITKE. Absolutely nothing. I think the sense of the——

Mr. SCHEUER. I don't say that in derogation of Canarsie, [phoenetic], because Canarsie is the homeland, the heartland of my congressional district. I honor Canarsie and the wonderful people that live there. But there used to be an expression when a cop was performing inadequately, they would assign him to Canarsie.

Mr. LITKE. I think unfortunately that is the attitude prevailing in the telephone system. They look to A.T. & T. as their future.

Mr. SCHEUER. Yes. Are you finished?

Mr. LITKE. Yes, sir.

Mr. SCHEUER. Mr. Bennis.

Mr. BENNIS. I am not sure that I can adequately answer both of the questions you posed here. But certainly, I think there is an area of business that the BOC's can be involved in and can be very productive and can keep them economically feasible. I don't necessarily believe that they have to be restricted to that very narrow, as I understand it, gage of business that the settlement has depicted.

I have no problem obtaining my telephone equipment, basic telephone equipment from the local operating companies as long as I have the option where, if it seems feasible economically and operationally, to go out and obtain equipment from other sources of supply.

So, I would certainly endorse the extension of their capabilities beyond those defined in this very narrow area of expertise that they are giving to them right now.

What are the legislative issues that should be addressed right now? I think you would have to be Solomon to really come out with that. We have S. 898 and H.R. 5158 which is probably going to be modified to some extent. We have got computer inquiry too. We have got the settlement issue. And it is a very difficult set of options that you must go through to come up with any kind of a meaningful answer.

Some of the things that I have addressed are the narrow issues that we as a particular group of users are very concerned about. But you have heard all afternoon each of these groups come up and outline that. I guess if I have any kind of advice that could be accepted at this time it would be to say, make haste slowly. I do not think it is necessary to enact something tomorrow only on the basis, not that there isn't a need for legislation, there is going to be a need for it, but on the basis that, as you hear from the various groups, and you begin to think through these issues, I believe you are going to have a clearer direction in which you should be going.

So, a hasty legislation might be the worst possible thing we could have.

Mr. SCHEUER. Thank you.

Mr. Simon.

Mr. SIMON. On the other hand, it may be the best thing you can do. It seems to me that my overall perception is that we have had a process whereby the court was about to restructure the industry, the FCC came up with its plan. Congress has spent 3 years doing it. Now, it appears that what has happened is that A.T. & T. itself is going to do it.

It seems to me that the most important thing would be for the Congress to take the initiative to come up with a final solution. I would endorse rapid resolution of all issues, or rapid congressional action based on the events that have happened. I would want to also emphasize that in our concern over the development of the— or protection of the operating company, that we don't in the process destroy the basic framework or concerns that underlie the antitrust action.

It seems to me that if we go too far in allowing the operating companies to undertake new activities, we will be recreating the monster that we are trying to dissemble in the first place. While I am totally sympathetic with the need to assure that there are adequate revenues to support healthy operating companies, I would hate to see us simply reverse the process that we have been trying, or the road or path down which we have been going.

Mr. MOTTL. Thank you very much, Mr. Simon.

One of the concerns which has been expressed about the proposed consent decree is that it would permit A.T. & T. to set up a private microwave link, for example, between its long distance switch and large users, enabling users to bypass the local distribution system, thereby avoid paying access charges.

As representatives of some of the companies that might benefit from such a development could you please comment on how this would affect the existing network?

Mr. Bennis.

Mr. BENNIS. Well, this is an iffy question. For example, I put in a private microwave system in Pittsburgh. I am in the process of putting one in. My reasons for putting that private microwave system in was the existing capabilities that were being offered to me by the local associated company, as well as the long lines department of A.T. & T. were not capable at that time, their facilities and their capabilities could not meet my operating requirements.

I wanted high speed data. I wanted switched high speed data. I wanted video conferencing. I wanted a combination of capabilities that would serve the automated office functions that we have been introducing. And it was not available to me.

So, I did put in, I am in the process of putting in this private system. Now, given a situation, a hypothetical situation, under the new laws, whatever they might be, where I could not obtain the capability from the Bell operating company, and/or it was being offered to me by the FSS, or whatever the new separate subsidiary might be of the Bell System or MCI or whoever, certainly as a consumer, a large business consumer, I would be interested in finding the most capable system available to me at the best possible price.

Mr. MOTTL. Does anybody else want to direct an answer to that?

Mr. LITKE. I would comment, Mr. Chairman, that if the unfettered competitive behemoth, A.T. & T., was in a position of bypassing the wire system of the basic operating company, the operating company would last for a relatively short period of time. And then we would be in serious trouble.

Mr. MOTTL. A.T. & T. maintains that its long distance service is subject to vigorous competition. Could you please comment on the availability of alternative transmission facilities which you are free to utilize, and would you characterize the long distance market as competitive?

Last year, A.T. & T. was granted a 16 percent across-the-board rate increase, as well as a 35 percent WATS increase. Could you please describe your reactions? Did these rate increases result in widespread defection of A.T. & T.'s customers?

Mr. SIMON. I could speak briefly from residential users and my knowledge of the data which indicates that A.T. & T. long line still has in excess of 90 percent of the market.

As to the impact of the WATS increase, those of us, even in the nonprofit community, using WATS service, it had a devastating effect. We did not and still have not left A.T. & T. because we still don't have enough options.

Mr. MOTTL. Did you want to comment?

Mr. BENNIS. Answering your second question first, Mr. Chairman, I had a mild coronary when I got those rate increases. It amounted to about 36 percent for Westinghouse, to the tune of about $10 million a year with no value added.

In regard to competition in the intercity transmission area, I think Mr. Magowan cited that they had something like 2 percent of the market. And I think all the other competitors combined, including Satellite Business Systems, another 2 percent, which leaves the dominant supplier with somewhere in the neighborhood of 96 percent of the market.

So, your options today, while they are increasing, the options today are still fairly limited. I don't consider that there is effective competition in the long-distance intercity area.

Mr. MOTTL. Mr. Litke.

Mr. LITKE. Mr. Chairman, just to compound the problems that you have as a legislator, let me point out that the city of New York, which has a $90-million-a-year telephone bill, is primarily a local user. The impact of long-distance rate increases is relatively minimal as it would affect the city of New York, only 5 percent of our telephone bill is related to long-distance costs.

So, our focus is on the viability and strength of the local operating entity, and on the cost of equipment. So, that just throws a little bit of a monkey wrench into part of the analysis and the confusion here.

Mr. SIMON. Under the consent decree as I read it, the operating company will decide what your local exchanges are, and you may end up having a lot more long-distance calls than you expect.

Mr. LITKE. Thanks for telling me.

Mr. MOTTL. Just for the record, Mr. Markey and I had objected strenuously to the FCC decision with regards to long distance and WATS. We asked for reconsideration. Unfortunately, we didn't get a reconsideration. It appears that the access charges will have to be determined with two goals in mind. To keep them from being too low so that the local operating companies aren't forced to increase their rates to customers, and could keep them from going too high in order to avoid driving large users off the network.

Are you comfortable with the manner in which the issue is resolved by the consent decree, leaving this determination up to the FCC and various State regulatory commissions?

Mr. LITKE. No, sir. I for one am not. I am a very strong believer in the legislative process.

Mr. BENNIS. As I pointed out, we are not too comfortable with that. That is one of the issues we raised. We see the possibility of as many as 50 different rates being established, using different guidelines, with no consistency.

Mr. Simon. I would concur with that. That seems to be one of the most confusing points in the consent decree. It is hard to understand how that is going to work out without some further action.

Mr. Mottl. Last question I have for you, Mr. Simon.

Would you briefly suggest to the committee what the residential users can do? Can they collectively unite some way? Would you have a suggestion for this?

Mr. Simon. Sure. I mentioned in the testimony before you came, with reference to the bill you introduced, Congressman, H.R. 5421, which is——

Mr. Mottl. That is a bad way to lead into that, isn't it?

Mr. Simon. But it is, given the lateness of the time, let me say there is a model for this in the State of Wisconsin where they have a Citizen's Utility Board.

Mr. Mottl. That is model?

Mr. Simon. Yes. Model for the bill. Wisconsin CUB has been in existence for 2 years, a State-chartered entity which covers not only telephone but all utility issues.

I would hope later in the session we would be able to bring witnesses from Wisconsin before this committee to go into detail on the successes they have, but after the short period of time, there is over 50,000, close to 70,000 members at this time. And through their interventions, have reduced, or through their interventions have saved consumers roughly $14 million in various rate proceedings.

The key to this process is to allow consumers to organize themselves through communications with the bills that are already sent out, or being sent out by the telephone company.

Mr. Mottl. You mean in a piggyback fashion?

Mr. Simon. In a piggyback fashion. What is nice about these plans is that there is absolutely no cost to the taxpayer. They are voluntary organizations. There is no new bureaucracy set. Once it is in operation it is a totally voluntary organization which provides for consumers to organize themselves. It just seems to me that as we talk about gigantic corporations working in an unregulated, deregulated environment, we too should be looking for ways to institutionalize consumer representation in these—in the future so you won't have to have these bureaucracies.

It can in a sense act as a self-policing force on behalf of the residential end user.

Mr. Mottl. This is such a good idea, it could be used for natural gas, electricity, post office?

Mr. Simon. Precisely. The model works in a number of areas.

Mr. Mottl. Does anybody else have questions? If not, the Chair would like to thank the distinguished panel for your great contribution this afternoon.

Without objection, the subcommittee will now stand adjourned.

[Whereupon, at 5:04 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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IMPACT ON IOWA

THURSDAY, FEBRUARY 11, 1982

House of Representatives,
Subcommittee on Telecommunications,
Consumer Protection, and Finance,
Committee on Energy and Commerce,
Cedar Rapids, Iowa.

The subcommittee met, pursuant to notice, at 8:30 a.m., in room D, Gage Memorial Union, Coe College, 1220 First Avenue, NE., Hon. Thomas Tauke (presiding), Hon. Timothy Wirth (chairman).

Mr. Tauke. The meeting will come to order.

This is the first meeting of the Telecommunications Subcommittee outside Washington, D.C., on a subject of tremendous importance to all Americans: the reorganization of A.T. & T., the world's largest company, and the legislation surrounding this reorganization.

I am honored to have with us today the chairman of the Telecommunications Subcommittee, Congressman Tim Wirth of Colorado.

Chairman Wirth has undertaken a methodical detailed approach in developing legislation on the issues we will discuss today.

Many hours of open meetings with the members of the subcommittee were held to define areas of agreement and to narrow those areas of disagreement in developing a vehicle for legislation on the topic of today's hearings, specifically H.R. 5158.

Clearly, a continuation of this process will facilitate the passage of progressive procompetitive legislation which addresses the needs of all parties involved and that is why we are here today.

Usually Congress is condemned for reacting to yesterday's problems instead of preparing to meet the needs and challenges of the future. Today's hearing is an opportunity for us to correct this criticism by preparing legislation which will meet the changing environment of telecommunications.

Testimony will be heard today from various groups who have not until now expressed their views on the recently proposed antitrust settlement between the Department of Justice and A.T. & T. In addition and perhaps more importantly, this hearing will be the subcommittee's first attempt to examine the proposed settlement from a rural prospective.

I believe that instead of going through all of the various people who will appear today, at this point in the hearing perhaps it would be appropriate to wait for each of those introductions until we proceed with the individual panels.

We are going to have a slight change in the agenda from the agenda that has been printed for you. We are going to ask Jack MacAllister, the president of Northwestern Bell Telephone Company, to be the first witness, and Andrew Varley will be the second witness rather than the way it is printed on the panel.

So Mr. MacAllister, would you please come forward.

While we are waiting for Mr. MacAllister to settle down, it is with a great deal of pleasure that I introduce the chairman of our subcommittee, Tim Wirth of Colorado.

Mr. WIRTH. Thank you very much, Tom, and I am delighted to be with you and be in Iowa and to be sharing the concerns that all of you have for telephone service in predominantly rural areas. The area of the country where I come from is the Rocky Mountain region, which has 25 percent of the land mass of the country and 3 percent of the population so, needless to say, we are very concerned about two issues in particular: One, the cost of telephone service. Are we going to be sure that we continue to have the best telephone service in the world which is available to everybody in this country at a price they can afford.

And, second, are we sure that that telephone service is not only going to remain of this great quality but continue to be viable, continue to be upgraded, so that the fruits of the telecommunications revolution, this wonderful set of electronic changes that are driving our economy in all kinds of new and very exciting directions, but the fruits of that are made available to everybody in this country.

In addition to the ratepayer issue, the consumer issue, the cost-of-service issue which is one, and the quality-of-service issue is second. Third are raised some very significant issues of competition as we make the transition of A.T. & T. away from what was effectively a monopoly environment to a competitive environment. We want to make sure that the rules of competition are fair.

Finally, there are a series of other issues that are of concern. One is how do we treat patents. Another is what are the implications of the settlement for international trade at a time when the electronics revolution and the telecommunications market around the world are changing dramatically. Third is what happens to the people who work for the Bell system, their contractual relationships, that whole set of labor-management issues that is to be decided here. There are a variety of very, very important issues.

I look forward to hearing from all of you and I want to thank again Congressman Tauke for asking me to come and be involved in this hearing. And I want to tell all of you that you are extraordinarily well-represented in the U.S. Congress.

And at a time when we hear a great deal about partisan activities, I am a Democrat and Tom is a Republican and I can tell you I can say that with great assurance and no feeling that Tip O'Neill or anybody will be charging down my back saying, "What are you doing saying something like that?" Tom is very, very good.

Tom, thank you very much for asking me to be with you and, Mr. MacAllister, I look forward to hearing from you.

Mr. TAUKE. Thank you very much, Tim.

Jack MacAllister is a native of Venton, Iowa, which is not too far from here, but he is here this morning not because of his birthplace but because he is president of Northwestern Bell Telephone

Co. We appreciate your appearance this morning and we want to thank you for coming and it's all yours.

STATEMENT OF JACK A. MacALLISTER, PRESIDENT, NORTHWESTERN BELL TELEPHONE CO.

Mr. **MacAllister**. Thank you. In addition to that, my parents went to Coe College, and this is kind of a nice opportunity to come back to see all of the developments at Coe College.

My remarks today are going to be primarily directed to the telecommunications environment that we see in the future as a result of proposed modified final judgment that was reached on January 8 of this year.

I will also have a few comments about H.R. 5158. But first I would like to give you a few numbers that relate to our business. Northwestern Bell presently serves about 5.6 million telephones in five States, Iowa, Minnesota, Nebraska, North Dakota, and South Dakota. Another 2.4 million telephones are served by some 350 independent telephone companies which make up a fine network of telecommunications providers in this particular territory.

Northwestern Bell's total plant investment is about $5.5 billion. We are currently spending for the last 3 years right near the $600 million a year figure for modernizing and expanding our facilities. About 26-27 percent of our plant expenditures have been for modernization during these years.

We have about 27,500 employees and 6,000 pensioners.

The owner of our business is A.T. & T. which is, in turn, owned by over 3 million people in the United States.

For many years we have had a business philosophy that can be best summed up in one sentence: To give the best possible service at the least possible cost consistent with fair treatment to our employees, to our customers and to the people who own our business.

The question of the hour seems to be how these various constituencies will be affected by this January 8 agreement.

It is appropriate, I think, to look first at the quality of service that we are giving our customers. We know that we will have, because we have now, first-rate plant and equipment. Of the recent capital spending, as I mentioned earlier, fully two-thirds or $400 million a year has been spent for modernizing our local exchange plant.

Of this amount, $50 million a year has been for electronic switching systems. Over half of our customers in the Northwestern Bell territory are now served by electronic offices.

Another aspect of modernization has been stormproofing our outside plant. This winter, as you all know, it has been a pretty severe winter everywhere in the midwest; in fact, everywhere in the country. Thanks to this program of stormproofing our plants, our rate of trouble reports is actually lower this year than it has been in previous years.

Now, this means better service to customers at a time when they need it the most and certainly a big savings to us in terms of maintenance. Our work forces are well-trained and they are efficient. And we will have access to a broad range of research and engineering and manufacturing skills.

As to the service to be provided by A.T. & T. under competition, I am sure that the challenge of beating or exceeding the efforts of other suppliers will be a substantial motivator for them.

A great deal has been written and said about the alleged upward pressure on local telephone rates. This has been somewhat surprising to those of us in the business who, since 1972, have been warning that the introduction of competition which ultimately pushes the price of service toward cost, would have an impact on the price of local service.

It is obvious from the record of our application for rate increases in recent years that it wasn't just talk.

Now, we haven't always been successful in our applications for rate increases but we have been aggressively pursuing a plan of increasing local service rates for many years. We have increased those rates on six occasions in the past 10 years just here in Iowa. The percentage increase has been very low and, as a matter of fact, I would imagine—I haven't figured this out recently but if you would relate it to the CPI—our increases would probably actually net out at a reduction in rates as opposed to an increase.

So, I think our productivity has been a great factor in keeping our earnings in reasonable line. So, I would simply say again that the pressure to raise local service rates should not be blamed on the consent decree. Rather, it has been caused by inflation which we all know about, by the growth competition which drives the rates for any product closer to cost, and by the more rapid turnover of technology which results in higher levels of depreciation rates.

This isn't to say that we have done nothing to hold down the costs. To the contrary, our record of improved productivity in the use of cost-cutting technology and broadened spans of control in our management, certainly, I think, can serve as a model for all industry. I was noticing the other day, in the last 5 years in Northwestern Bell we have increased our total plant by some 66 percent and during that same period of time we have been operating with 3 percent fewer people.

In concert with the regulatory commissions in our territory, we are also accelerating the introduction of measured service so that customers, themselves, can have a hand in controlling the amount of their bill. The Iowa Commerce Commission recently authorized a trial of this service in Marshalltown and trials of measured service are going on in all five States at the present time.

The question of how employees will be affected in this agreement is one that I think we can handle. Very simply, the modified decree makes no change in employee benefits or pensions for either active or retired employees. It doesn't alter any existing bargaining agreements covering the Bell employees.

As a business, we have been through many, many periods of change and we have fortunately had the opportunity to work with a very tough but fairminded union who was interested in the success of the business, along with the interest of their employees.

Our conversions from manual to dial impacted on many, many people. From mechanical switching to electronic switching has impacted. From manual drilling to computers and many, many other transitional periods our company has gone through, and all of these have been handled with an absolute minimum of disruption in the lives of our employees and their families. This has largely been due to the fact that we have worked very, very closely with the Communications Workers of America in planning for these changes.

The result in almost every case has been improved working conditions, more opportunity to use judgment and initiative, and more challenge. So whether employees stay with the Northwestern Bell Telephone Co., should this agreement go through, or go with A.T. & T., they will benefit from being with a financially sound company that has a long history of treating employees fairly.

Next I would like to comment from a shareholder's point of view, what kind of company will we be from a standpoint of services offered and earnings.

I get a little frustrated at the characterization from some quarters that the local exchange businesses will be a regulated cable and wire company. I think that we are going to have a pretty attractive list of services to offer and I think it is an insult to management to think that we can't use the assets that are left to our control for the benefit of the shareholders and the customer.

First, we have got an established local exchange business that serves nearly 97 percent of the residences in our territory and almost 100 percent of the businesses.

Now, that's not bad for starters. That's a pretty good customer base. Then we are going to be concentrating our talents on expanding the uses of these lines and switching equipment and that's where measured service again is very, very important and the key to our future.

One of the advantages we hope to derive is having more suppliers in the market. One of the advantages we will have by having more suppliers in the market, in the interstate market, is that they are going to be thinking up new and novel ways in addition to ourselves for the use of local exchange terminations. A partial list of these expanded services can include remote reading of utility meters. We have been experimenting with that and it appears as though that's a very viable possibility. Certainly enhanced facilities for alarm service companies, assisting customers by telephone shopping and ordering from catalogs, stimulating use of public announcement services like time and weather and results of sports athletic events, maybe even sampling public opinion and the use of telephone votes.

And certainly, in addition to that, we are going to continue to be promoting the use of long distance services because with access charges that are contemplated, of course every call that is completed means more revenue to the local operating company.

Then as information age technology and customer needs develop, measured service, as I mentioned before, will add more strength to our financial picture. Our customer billing capabilities are another possible revenue source. The decree would permit us to provide billing for any interexchange carrier as long as we meet certain conditions and we plan to aggressively pursue that idea.

As a local exchange company, we also expect to be providing advanced mobile telephone service, cellular radio telecommunications. I would certainly add access charges as still another means of offsetting the loss of subsidy from the long distance calls, as I mentioned before. Unquestionably such charges are in order to compensate local companies, independent companies, for the use of local plants.

We, of course, want to be certain that such charges are fair and reasonable and that they not be mandated so high as to encourage efforts to bypass the local exchange plant.

Finally, how does the House bill 5158 fit into this new environment? The modification of the consent decree, I think, moots many of its provisions. In its current form, I think the bill would be an outright handicap to the Northwestern Bell Telephone Company.

I believe it would harm our ratepayers by holding back new services. For example, the bill seems to revoke or, at best, delay the FCC's recent reaffirmation that local exchange companies should be able to offer cellular services.

Some of the procurement provisions in that bill would seem to prevent us from buying the best equipment at the lowest possible-cost. It would force us to make public the results of our technical research, projects we have invested in in behalf of our customers, and this would obviously weaken us competitively.

Now, you wonder how can a regulated exchange company being described in the consent decree worry about that. Well, we are going to be extremely competitive in terms of having to offer the very best access opportunities to interexchange carriers. If we don't, they will bypass us so it is going to be a very, very competitive field under regulations as far as we are concerned.

Altogether these provisions ignore the fact that although we are in a regulated business, we also have to be competitive. I would like to be able to manage our business with as little Federal Government intrusion as possible. The Iowa Commerce Commission provides constant checks and audits on our performance. Sometimes I think they do almost too good a job. It will demand good service at reasonable cost but I and the managers must run the business. And if we don't do a good job, our regulators, as we have found in the past, will remind us of that. Our customers will remind us of it and our investors are going to yell like crazy. So from my point of view, I'd like to get on with the job of running the telephone business and get out of the courts.

[Mr. MacAllister's prepared statement follows:]

Statement of
JACK A. MAC ALLISTER
PRESIDENT
NORTHWESTERN BELL TELEPHONE COMPANY

My name is Jack A. MacAllister and I am President of Northwestern Bell Telephone Company. An Iowa native, I attended high school at Vinton, college at Cedar Falls and graduated from the State University at Iowa City. My telephone career began as a craftsman in Council Bluffs and has included many jobs in Iowa, including that of Vice President and Chief Executive Officer for the state. I also have served in the contract relations organization of AT&T with responsibility for intercarrier relations. Currently as President of Northwestern Bell, I am responsible for the Company's operations in Minnesota, Iowa, Nebraska, North Dakota and South Dakota.

I welcome the opportunity to appear before this subcommittee to discuss the telecommunications environment we see in the future as a result of the proposed Modified Final Judgment filed on January 8, 1982 by the U.S. Department of Justice and AT&T. I would particularly like to comment on the effects of this action on the quality and cost of services we offer the public, on the jobs we provide our employees, and on the Company's future service and earnings prospects.

Actually these three subjects are very closely related. One thing I recall very vividly from training I received on one of my first jobs was a picture of a three-legged stool. The success of our Company, we were told, rested on three legs -- our ability to give good customer service, to treat employees fairly, and to provide a fair return to the investor or owner of the business. To treat any one of those constituencies in an unequal way would be to shorten one of the legs. If you have ever tried to sit on a three-legged stool with that kind of an infirmity you know it leaves something to be desired.

Here are a few numbers to describe our business. Northwestern Bell presently serves some 5.6 million telephones throughout our five-state territory. Another 2.4 million telephones are served by approximately 350 independently owned companies with about 150 of these companies in the state of Iowa. Northwestern Bell's total plant investment is about $5.5 billion. We currently are spending about $600 million each year to modernize and expand our facilities. We have approximately 27,500 employees and 6,000 pensioners. The owner of the business is AT&T which in turn is owned by some three million shareowners.

The question of the hour seems to be how these constituencies will be affected by the January 8th agreement.

Effects On The Public -- It is appropriate I think to look first at how service quality will be affected.

As for our local exchange company, we'll know our job well. We will continue to provide exchange service with the same dedication and capabilities as today. Of our recent capital spending, fully two-thirds has been for modernizing local exchange plant.

Of the $400 million we have been spending each year on local exchange plant, $50 million a year has been for electronic switching systems. Over half of our customers are now served out of electronic offices. Here in Cedar Rapids we are installing another electronic switching system this year in our Marion Office. Since 1975, we have spent $18 million on new electronic offices just in Cedar Rapids.

Another aspect of the modernization program for our local exchange facilities has been stormproofing outside plant. We have buried cable in most of our territory today. This winter has been unusually severe in our territory, but thanks to the stormproofing program, our rate of trouble reports is actually lower than in previous years. This obviously permits us to realize savings which help to offset the impact of inflation.

You can be sure we'll be staffed with well trained, innovative and efficient workers. And we'll have access to a broad range of technological research, engineering and manufacturing skills from a multiplicity of suppliers. In the case of services to be provided by AT&T under competition, there will be the challenge of meeting or exceeding the efforts of other suppliers.

One concern that has captured far more than its share of attention since the announcement has been the alleged upward pressure on local telephone rates. This has been somewhat surprising to those of us in the business because we have been predicting it for years -- long before we ever heard of divestiture. As far back as 1972 our officers and managers have been warning that the introduction of competition in what had formerly been considered regulated monopoly markets would force us to look at pricing alternatives that departed radically from traditional rate-making principles.

It is obvious from the record of our applications for rate increases in recent years that it wasn't just talk. In Iowa alone we've increased local service rates on six occasions in the past ten years. Based on a rate filing in Iowa last fall we increased local service rates on January 1, 1982. In Cedar Rapids this amounted to an increase for a residence customer's line from $8.00 to $8.80, or a 10% rise.

Thus I would simply reaffirm that the pressure currently being applied to raise local service prices is not a function of the consent decree. Rather it is caused by inflation, the growth of competition which drives rates for any product or service closer to cost, and the more rapid turnover of technology in the competitive marketplace with the necessarily higher charges to depreciation that result.

This is not to say we have done nothing to try to hold costs down. To the contrary our record of improved productivity, use of cost cutting technology and broadened spans of control is a model for all industry. In concert with regulatory commissions in our territory we are also accelerating the introduction of measured service so that customers themselves may have a hand in controlling the amount of their bills. Here in Iowa, we are engaged in a trial of measured service in Marshalltown. We will be working with the Iowa Commerce Commission to evaluate the trial results and expand measured service throughout the state.

Effects on Employees -- The question of how our employees will be affected by the agreement is one that would concern me a great deal if I were not so certain of our ability to handle the situation. Very simply the modified decree makes no change in employee benefits or pensions for either active or retired employees. It does not alter any existing bargaining agreements covering Bell employees.

As a business Northwestern Bell has been through periods of change many times. Our conversions from manual to dial service occasioned vast retraining and rescheduling of work forces. The transition from mechanical switching systems to electronics, from open wire transmission to microwave, from manual billing processes to computers and many other technologically and socially driven changes have been handled with an absolute minimum of disruption to the lives of our employees and their families. The result in almost every case has been improved working conditions, less repetitive work, more opportunity to use judgment and initiative, more challenge.

I am confident that we will handle any change in assignments that the modified decree brings about. Whether employees stay with our Company or go with AT&T, I know they will benefit from being with a financially sound company that has a long history of treating its employees fairly.

Effects On The Company -- Next I said I would like to comment on my Company's prospects for the future as they relate to both services offered and earnings. I hope you will pardon if I chafe a bit at the characterization from some quarters that the local exchange company business will be relegated to a cable and wire operation. If anyone takes the time to think about what we will have going for us it does not take long to come up with a pretty attractive list.

First we have an established local exchange business that serves nearly 97% of the residences and close to 100% of the business, professional and governmental offices in our territory. Multiplying the usage of these lines and switching equipment will be an important objective. One of the advantages we hope to derive from having more suppliers in the market is to have other entrepreneurs conjuring up ways for our customers to use our services for both local and interexchange connections. We intend to work with others to develop practical applications of our services to meet the needs of the coming Information Age.

We have already conducted experiments in reading utility meters remotely over the telephone line. Providing transmission facilities for alarm service companies is another application we can accommodate. The Knight-Ridder trial in Coral Gables, Florida proves that our services can be used to assist customers in shopping and ordering from catalogs.

We can stimulate usage of public announcement services like time, weather, scores and results of athletic events. Surveys can be conducted using a telephone vote.

In all of these uses the introduction of measured service plays a key role. To the extent that the new uses provide a value to our customers, we think the public will appreciate them. As Information Age technology and customer needs develop, measured service will add still more strength to our financial picture.

Our billing capabilities are another possible revenue source. The decree would permit us to bill for any interexchange carrier as long as we meet certain conditions. We are very efficient in this area and I think we could offer some extremely attractive services that would be profitable to us as well.

So far I have said nothing about Advanced Mobile Phone Service and cellular radio telecommunication. As a local exchange company, we expect to be providing this exciting new service. Although mobile services have not in the past been a large part of our revenue stream we have never had anything as good as cellular radio. I am very happy at the thought of including it among the services we can offer.

Much has been said and written about access charges as a means of offsetting the loss of subsidy from long distance calling. Unquestionably such charges are in order to compensate local companies for the use of local plant. They are to be charged on an equal basis to all interexchange carriers. To the extent practicable these revenues can be used to hold down the cost of local service to our customers. We, of course, must be certain that such charges are fair and reasonable to all concerned. Care must be taken to assure they are not set so high as to encourage efforts to bypass local exchange plant.

Finally, it should be pointed out that profitability is also a function of expense control. Looking to the immediate future the local exchange companies may still avail themselves of the cost cutting technology and engineering expertise of the Bell Laboratories and Western Electric. Fiber optics are on the way with at least two Iowa applications already approved -- in Mason City and Des Moines. Digital transmission systems which have been a part of our interexchange plant for some years are now being used in the local exchanges.

In addition we're harvesting hundreds of cost saving and revenue producing ideas from employees who have been stimulated by the prospect of fashioning their own futures in this time of great change.

H. R. 5158 In The New Environment -- How does H. R. 5158 relate to this new environment? The bill was drafted before the announcement of the agreement reached between the United States Department of Justice and AT&T. The modification of the Consent Decree, I believe, makes moot some of the provisions in H. R. 5158. In my view the legislation in its current form would be an outright handicap on our Company. I think it would harm our rate payers by holding back new services. For example the bill seems to revoke or at best delay the FCC's recent reaffirmation that local exchange companies should be able to offer cellular services.

Some of the procurement provisions would seem to prevent us from buying the best equipment at the lowest cost. The bill would force us to make public the results of our technical research -- projects we've invested in on behalf of our customers. That would obviously weaken us competitively.

All together these provisions ignore the fact that we have to be a competitive business. I'd like to be able to manage our business with as little federal government intrusion as possible. The Iowa Commerce Commission provides constant checks and audits of our performance. It will demand good service at reasonable costs. But I and my managers must run the business. If we don't do a good job our regulators, our customers, or our investors are going to tell us. Let us get on with it.

Mr. Tauke. Thank you, Mr. MacAllister.

Congressman Wirth.

Mr. Wirth. Thank you very much, Mr. Tauke.

Mr. MacAllister, I understand that we had also asked to testify today representatives of A.T. & T., as opposed to the operating companies. As I believe everybody here understands, the settlement has effectively split off the Bell operating companies like Northwestern Bell from A.T. & T. And it was our concern in the subcommittee and it has been our concern to make sure that we understood where the interest of the operating companies stopped and the interest of A.T. & T. began, that they are now two separate entities. But A.T. & T. said that they did not want to come and testify and they thought that you could represent both the operating companies and A.T. & T. Is that correct?

Mr. MacAllister. As president of Northestern Bell, I am also an officer of A.T. & T. And I feel that I can represent the interests of A.T. & T. They have appeared before you on many, many occasions and as I understand, there is going to a full series of A.T. & T. people as well as associated company people appearing before your committee in the next several months.

Mr. Wirth. Again, the issues to make sure that the people in the State of Iowa understand that there probably are two different sets of interest here and let me ask you about one example that comes up over and over and over again and that's the example of Yellow Pages. As I believe everybody here knows, Yellow Pages contributes a significant amount of revenue to the local operating company which, in turn, keeps down local rates. In the State of Colorado, that revenue from Yellow Pages contributes about $1.20 a month to local telephone bills. In other words, our local telephone bills in Colorado are now an average of $8 a month. If it weren't for the

Yellow Page contribution, they would be $9.20 a month. What is the approximate contribution of Yellow Pages here, do you know?

Mr. MacAllister. Pretty much the same.

Mr. Wirth. Pretty much the same; about $1.25. Under the settlement as agreed to by A.T. & T. and the Justice Department, Yellow Pages moves to the parent company. The Yellow Pages which has been in the local rate base, moves to the parent company.

Is it, do you think, in the interest of Northwestern Bell to have Yellow Pages move out of Northwestern Bell and move to the parent company.

Mr. MacAllister. Well, you know, if I had my way, the Congress and the courts would have left the Bell System alone. I think we were providing a pretty good service at reasonable rates but the public interest seems to have led us to believe that the Congress and the FCC and the courts were concerned that the horizontal and vertical structure of the Bell System could not result in a fair and competitive marketplace.

One of the theories of the Justice Department in proposing this agreement was that you should separate all competitive services from so-called monopoly services. Yellow Pages, as you know, is a highly competitive service and has been for years. We still own the data base, the basis for which the Yellow Pages are put together.

Mr. Wirth. How many Yellow Pages are there in Cedar Rapids?

Mr. MacAllister. I frankly don't know.

Mr. Wirth. In Dubuque?

Mr. MacAllister. General Telephone is a competitor of ours in Minneapolis.

Mr. Wirth. Is there more than one Yellow Pages in Dubuque or in Omaha?

Mr. MacAllister. I think there are some neighborhood directories in most.

Mr. Wirth. There is only one Yellow Pages in Denver. The argument is made by A.T. & T. that somehow Yellow Pages is a competitive endeavor, right?

Mr. MacAllister. It is.

Mr. Wirth. In every town that I represent and almost every place that I have seen in the country, except where there is another local operating company like J.T. & E., the Yellow Pages is a monopoly service. There is one Yellow Pages, "Let your fingers do the walking," right?

And it seems to me that, you know, in a local area—let me go back to the question—all right, do you think it is a good idea to take Yellow Pages and move it to the parent company, right, therefore losing that subsidy for local rates? Or should Yellow Pages stay and help have the revenues through the Yellow Pages which have been built by small businesses and customers of that local company for years and years and years, to have that stay in the local community where it started.

Mr. MacAllister. I think that it is a process that is going to clear up a concern that has been registered by the courts and by the Congress and by the FCC, in terms of the mixture of regulated and competitive services. I think that we are going to be able to sell our basic listing services to other suppliers of telephone directory service and I think we are going to be able to make some money on that.

Now, to give you one example—you said you are not familiar with one—have you ever been in Crested Butte, Colo.?

Mr. **Wirth**. I have had a house in Crested Butte for about 20 years.

Mr. **MacAllister**. So do I. And in Crested Butte, Colo., there are two telephone directories. Are you familiar with that?

Mr. **Wirth**. Crested Butte, Colo., is a town of, I think, maybe 1,000 people at the outside, right? A very small and unique mountain community.

I was in New York City last week, right? I went to use a public telephone and there were two telephone books there. There was a Manhattan directory and there was New York City Yellow Pages. There was one Yellow Pages, right? Now, I looked in my room this morning in the hotel and there was one Yellow Pages. I checked recently in Denver and there are two Yellow Pages in Denver. One is Yellow Pages for small business and the other is Yellow Pages for big business, right? But they are all Mountain Valley Yellow Pages.

Let me ask you again, Mr. MacAllister, do you think that Yellow Pages—you know, you are an officer of A.T. & T. and an officer of Northwestern Bell—do you think the Yellow Pages ought to be kept in the local operating company or moved to the parent company?

Mr. **MacAllister**. Well, let me answer it this way: I would prefer if the telephone business would be left just as it was.

Mr. **Wirth**. Mr. MacAllister, the decision has been made by A.T. & T. and the Justice Department. I don't want to beat up on you because you were not one of the people raising this issue and it was Mr. Baster (phonetic), and Charlie Brown, the chairman of A.T. & T., who came to this agreement. That has been made between A.T. & T. and the Justice Department, to settle a long-term suit.

The point that I want to make is that it seems to me that you are put in an impossible position. The Bell operating companies are put in impossible positions. And that is why we asked an executive from A.T. & T., not representing an operating company, but representing A.T. & T., and while it is very clear that there are, it seems to me, very different interests at stake here between the local operating companies whose obligation it is and have done a brilliant job over the last 60 or 70 years to provide universal service to people at a cost they can afford, and to develop services like Yellow Pages, which help to make sure that rates were kept down.

Now, we are in a situation under the settlement, when it is alleged that Yellow Pages are competitive. Just on the surface, you know, I understand that that's what A.T. & T. is saying. This doesn't make any sense and the Yellow Pages ought to stay in the local rate base and that that's, you know, where the revenues and the growth of Yellow Pages has been built by businesses in every community.

There are distinct differences of interest between what the local operating companies are going to do and what the parent company is going to do and this is one very visible, very clear and very understandable example. There are a number of other ones and the point that I am making is just to reflect my own unhappiness that it is very difficult for us in the Congress to get answers to what is in A.T. & T.'s interest and what is in the local operating company's interest and that is something that we are going to continue to pursue.

Again, I don't do this to beat up on you, Mr. MacAllister. You are in a very difficult position. But, rather, to illustrate the kind of a problem that we have here. There are a variety of other things that I would like to get into but let me yield back to you, Mr. Tauke, whatever time I might have remaining.

Mr. **Tauke**. Thank you, Mr. Wirth.

Mr. MacAllister, when we invited A.T. & T. to appear before the hearing, the response we received back is that the interests of the parent company and the interest of the local service company are one and the same.

It almost seems to me to be suggesting, then, that we have not had any impact from the consent decree that was issued because if the consent decree says anything, it seems that it says that for the first time the interest of A.T. & T. parent is not going to be the same as the interest as the local service company. So you are in a difficult position.

I wonder if you could tell us when this split, this differentiation of interest is going to occur and perhaps, more importantly, when are the local operating companies going to begin speaking up so that the rape doesn't occur and then after it's over, then we will find that the people are going to throw up their hands and say, "Oh, we didn't do too well in this split."

Mr. **MacAllister**. Well, first of all, at the day of the split, I will have the same shareowner to be responsible to that I have today. But it is a matter of taking my ownership in A.T. & T. and giving it to me in two different parcels or three different parcels or whatever it might be.

So I am having the same shareowners tomorrow as I have today.

Mr. **Tauke**. Mr. MacAllister, if I may interject, we have had some wonderful railroad companies in Iowa that took profits from the railroad business and they put it into other businesses. They split the corporations and the shareholders had the same shares the following day as they did the day before. But the shares that happened to be in the other businesses prospered. That end of the company prospered and the other end went down the tubes. And those railroads went bankrupt.

Now, it is our fear that you as president of Northwestern Bell may be presiding over that end of the business which might not do so well. You are getting two-thirds of the assets maybe and one third of the profits and that's our concern.

You know, we are trying to be on your side but it is awfully difficult because we can't find anybody to speak out for your side.

Mr. **MacAllister**. Well, I hope that in my statement, I hope that in my comments, I am speaking from my side. I, personally, think that our company can be very successful under the ground rules that have been stated. We have had input into what happens, you know, in the event of divestiture. This idea of divesting the local companies from A.T. & T. isn't a brand new one, you know.

As a matter of fact, 1 year ago I was asked to head a committee of Bell system presidents to make recommendations of what would happen were this divestiture to occur. So the operating presidents have had the opportunity to speak up and present their interests.

Now, sure, our business is going to be somewhat different but we are starting out, as I said, with a modern plant, with trained people, with a strong customer base. We have opportunities to improve our revenue strength. We plan to maximize the amount of money that we can obtain from the directory listings which we, alone, hold. We are going to sell them to the highest bidder, whether that be A.T. & T. or somebody else.

I can provide, if you are interested, a list of exchanges where we have competitive books. Minneapolis is one. The most lucrative of markets are the ones that are usually impacted by either neighborhood or total community directories.

And so we think there is a great market for directory listings and we plan to sell them. Also the challenge that we are going to have is to provide innovative and competitive interconnections to all of the many, some 200, suppliers of intercity service that presently exist in the United States. And that's going to be a great revenue opportunity. Also the measured service concept and stimulating the usage of local service and getting away from the flat rate concept is another important factor in our future.

So I just disagree that we are being left with a failing business. If the business fails, I, personally, think that it's going to be a management problem and not a result of this decree. We don't make public interest. We try to respond to it. And the public interest in the Congress, as you well know, has all been directed toward the concern over the bottleneck that exists between the interstate business and the intrastate exchange business. That has been addressed by the consent decree modification and I think we can live with it and I think we can profitably live with it.

Mr. TAUKE. Mr. MacAllister, as you know, a number of people have appeared before our subcommittee suggesting that when we strip the local service companies of their ability to provide services except those at the local exchange level and the wiring up to your home, and did not allow them to be in the more lucrative market of selling equipment, let's say, for a business, a PBX system and the like, and not allow the company to be in the more lucrative long distance business, that two things occur: One, because you have less money coming from those other segments of the business, local rates go up; and, two, you set up a situation where you have a company that is constricted in what it can do. But other people, including A.T. & T. parent, can come in and begin to pick off various segments of that service base that a local service company would have.

So this permits rates to go up and the survivability of the local company to be endowed. We are, you know, concerned that maybe we should be modifying the consent decree to give Northwestern Bell and companies similar to it, however this is going to be structured, the ability to run the Yellow Pages as Congressman Wirth mentioned, or the ability to, perhaps, provide some other kinds of services.

Do you think that this would be a good step for Congress to take or would that be an unwise step for Congress to take?

Mr. MacAllister. Well, I am a little bit perplexed. As I understand and I am not an expert, but on Congressman Wirth's bill, one of the aspects of that bill would say that we would be in the business of providing terminal services or stations, PBX's, and so forth, only on a temporary basis. As I recall, it was a 2-year phase out basis in which we couldn't sell anything new, but could just maintain the installed base and would sell that base to the customers at the end of that period.

And so, in effect, that bill would say that we would be presiding over a dying business and that, of course, is extremely difficult and costly because we'd be maintaining the maintenance.

Mr. Wirth. If the gentleman would yield just very briefly, this is before the settlement. The legislation we are talking about was introduced in December before the settlement. The concern at that point was what is the relationship going to be between the regulated parts of the Bell System and the unregulated new competitive parts which we all want to see flourish, Bell getting into computers and data processing and so on. And it was that transition period, I think, that the provision that you are talking about obviously is now moot or very close to it, given the fact that we have had the settlement. So I am not sure that that's a relevant part of the discussion. I think the discussion now should focus on what should the Bell operating companies be allowed to do and not to do so that they can try.

Mr. MacAllister. Well, then, it isn't your intention to pursue the bill that is presently out of the committee?

Mr. Wirth. Well, it is very clear that 5158 was introduced before there was a settlement. H.R. 5158 has to change. H.R. 5158 was based upon the assumption of an integrated system. It is no longer an integrated system because the settlement has separated the Bell operating company from the parent.

So what we are trying to do is to get a flavor of how should 5158 or an alternative piece of legislation be written to assure that ratepayers are not seeing a doubling or tripling of rates to make sure that Bell operating companies are viable concerns, and so on.

Mr. MacAllister. So we wouldn't be considered a dominant carrier anymore?

Mr. Wirth. Well, the local operating companies are certainly a dominant carrier in that fashion. There is only one operating company in the jurisdiction in which you would find Northwestern Bell.

Mr. Tauke. Well, if I may say—I don't want to get sidetracked—it occurs to me the question is should we modify the consent decree in legislation to permit the local operating companies to have additional services beyond those suggested in the consent decree or should we not? Would that be helpful or a hindrance?

Mr. MacAllister. Well, I will tell you, naturally I would like all market opportunity that I could get. But I tell you, there is one thing that I would like to do and that is get out of the courts and get out of the antitrust business and get out of the halls of Congress and do my telephone business.

And all of the preoccupation in the past seems to be with size and alleged power and it has to do with the horizontal and vertical nature of the Bell System and everything that happens seems to relate to that.

Now, if by legislation you want to put us back into some of those businesses and somehow or other we can proceed with providing good service and doing what we know best and that is to do the telephone job, I would be tickled to death to see it. But I don't want to set up another situation where we will have to go through yet another tiresome round of lawsuits and challenges for me to answer because the answer has to relate to the climate in which we would be living.

If we could live in a climate in which we wouldn't be challenged in some way by questioning of our authority to be the only provider of Yellow Pages or somehow or other subsidizing the Yellow Pages so that other people who are in the business couldn't compete, then we would be right back into the mess we are in.

If we could avoid all that, if there would be some kind of a magic formula that could be developed that would say, "Look, that's your business and you don't have to worry about competition in that business; that's yours," that would be something entirely different.

Mr. TAUKE. As president of Northwestern Bell, you would be very pleased with the consent decree as it is and you don't think that you would prefer or would prefer not to have some modifications to expand the services you would offer?

Mr. MACALLISTER. My position is this: The consent decree seemed to respond to many of the concerns that have been voiced in Congress and in FCC and in the courts. It seemed to deal with the fundamental underlying concern that people have had about the Bell System. These are the people who are the ones who express public interest; we don't.

And so therefore it would appear as though this modification of the consent decree——

Mr. TAUKE. Mr. MacAllister, the reason we have you here is because you are an expert. We are not.

Mr. MACALLISTER. Right.

Mr. TAUKE. We need to know from you what's helpful to the system and what isn't.

Do you have any idea yet whether the companies—under current plans there will be 22-24 operating companies, 10 operating companies. Can you give us any indication what you think might be a proper way to try to restructure the operating companies?

Mr. MACALLISTER. This is still under consideration. As a matter of fact, I am on the committee considering that. We are still looking at a rather broad range of options, all the way from 48 companies to 1 central holding company.

Frankly, I think that the one central holding company has many disadvantages because it carries the power and size issue with it. So my personal feeling is it is going to be something different than that. Now, whether it is 6 or 7 or 8 regions, or whether it is 22 independent operating companies, we haven't really decided yet.

Mr. TAUKE. On the local exchange rates—and this is the last area that I want to touch on—has there been any discussion about how local exchange areas would be defined and do you have any suggestions for the subcommittee as to how we might view that whole decision area about the local exchange rates?

Mr. **MacAllister**. The definition of the local exchange boundaries is one that is also under consideration. There is going to be a lot of input from independent companies. There is a committee of Bell System presidents that is looking at that. And it would seem to me that one of the suggestions that I could make would be that once this plan is put together and presented to the Justice Department for approval, it would give the Congress an opportunity to relate to the specific plan.

Frankly, this decision occurred on January 8, and we haven't put together the final details of the plan. But we do plan to get some broad input into that decisionmaking process and I think when the plan evolves, it would be well to take a look at it and see whether public interest concerns have been met.

Mr. **Tauke**. Mr. Wirth, do you have anything further?

Mr. **Wirth**. Well, again, Mr. Tauke puts it very nicely when he says we are trying to be on your side. We are very concerned about the impact that this settlement is going to have on the rates that subscribers in this country pay and we are very concerned that the viability of local telephone service remains real and is allowed to continue to upgrade.

Now, back to where we started, one of the ways we all got into this is that the Bell system came to the Congress 7 years ago and asked the Congress to set basic telecommunications policy. Why? Because there were a lot of new developments going on and A.T. & T. argued very persuasively and correctly, I believe, that it should be the Congress and not the regulators or the courts that should be setting national telecommunications policy.

Now, we have had since then a number of iterations and a lot of discussion and a lot of agreement on where that policy ought to go. In the middle of all of that or at the end of all of that, on the 8th of January, comes down a 22-page document. I believe the settlement document is 22 pages long, which raises a lot of the concerns that we are concerned about, again going back to what you all asked to begin with, whether it was Northwestern Bell or A.T. & T., that the Congress set national telecommunications policy.

What we are trying to do, Mr. MacAllister, is to surface the issues and concerns that are there that go right back to that basic direction that you all asked us to take on and that we properly ought to take on as to what is in the best interest of a national telecommunications policy that the Congress ought to set.

We are here also to ask you and operating companies and A.T. & T. and all of the other witnesses this morning and in other hearings what are the problems and what should we be thinking about? You all are the experts. All right, we are trying to dig out those concerns. There are a lot of them. We have touched upon some this morning. There are others related to equipment, others related to the access charge, who sets the access charge, others related to the relationship between State public utilities commissions and the Federal Communications Commission, so that we have one national system, on the one hand, but how much local jurisdiction is there? There are a lot of very, very interesting and vexing and deeply important issues.

Let me just, with that, ask you do you think that the Congress should continue to pursue legislation?

Mr. MACALLISTER. Yes.

Mr. WIRTH. You do? Good. That is what we are here for. Thank you very much.

Mr. TAUKE. I might just say we certainly do not want to, as my colleague said earlier, beat up on you. It is just that it has been so frustrating attempting to get anyone to speak for the Bell operating companies. We don't believe that the interests of the Bell operating companies are any longer the same as the interests of A.T. & T. When we talk about things like yellow pages and the way in which all of these very complex financial transactions will occur and when we talk about the future bonding capability for a company like Northwestern Bell or whatever the local operating company would be called and the only thing you can get is, in a sense, the party line from A.T. & T. without having anybody speak up for the local companies to tell us what their potential problems might be, it is difficult.

Mr. MACALLISTER. Well, I disagree with your party line analogy. My whole business life has been with the Bell system. I believe that that Bell system provided damn good service at a reasonable price.

Mr. TAUKE. I agree.

Mr. MACALLISTER. It wasn't at my initiative or anyone at A.T. & T.'s initiative that the structure of the Bell system was basically changed. I am put in a difficult position, not by the fact that I am going to represent an independent company, but rather by the frustration I have over what kind of a climate am I going to be allowed to operate in.

You know as well as I do that the rules and regulations and inhibitions that were being placed on the Bell system, if they were to continue, would make it very difficult for me to operate. I don't know what you have in mind.

I think that if I am allowed to get back to the business of running the telephone business that I can take $3.2 billion worth of assets and a strong customer base and I think I can make money. That's my honest opinion and I want to stay with Northwestern Bell and do that. I don't want to go to A.T. & T.

Mr. WIRTH. Terrific, and we want to have you stay. The able managers ought to be staying in the local operating companies and that is terribly, terribly important that that happen. But we want that $3.2 billion worth of assets to be real assets, for example, in the asset transfer between the parent and the local operating companies. Who picks up what kind of debt and how will that be determined?

I mean, there is nothing in the settlement that suggests how various assets are going to be transferred, whether the local operating companies end up with the newest and best technologies, what happens to the debt? Does the long-term debt from years ago that was developed and gotten at a relatively low rate go to the parent company? Does recent debt at high interest rates go to the local company, therefore putting a greater burden on the local operating company?

I mean, these are all concerns that we have and we want to make sure that Northwestern Bell or Mountain Bell or New York Tel or Southern Bell remain viable, going, profitable and quality concerns. I mean that is our concern and Tom Tauke focused it very nicely that the local operating companies not go the way of the railroads.

I think that's the analogy that perhaps summarizes it. That's our concern and we want to hear from you, to make sure—that is why we are here—that we are focusing on those issues, that we understand them, that you understand them and that we altogether continue to make sure that the best service in the world is available at price people can afford.

Mr. MacAllister. The FCC has suggested, among other things, that this decree should be reviewed at least once every 10 years because of the emergence of the technology and the development of the industry. I, personally, think that is too long a time period. I think it should be reviewed more often and I think it should be reviewed by the people who represent the public interest.

I would like to have a clear definition of what the public interest is. I don't make that. I try to respond to it. You make that. It has been very unclear to me over these years of being in court battles and lawsuits and antitrust suits and congressional hearings and all the rest of it, it has been awfully difficult to know just what that public interest is. If you are from Congress and here to help, I'd love to have a strong definition of what is the public interest in this new emerging world of technology? I'd love to know what it is. I'd love to respond to it. I'd love to respond to it in a climate where I wouldn't have to go to court every other week to fight with somebody because they said that we weren't operating in the public interest. That's what I'd like.

Mr. Wirth. That is what we are attempting to define and that is why we all agree that legislation is imperative. Certainty, right, you want certainty?

There is also another analogy. We get redistricted every 10 years, Members of Congress, and you never know where you're going to be, right? What's going to happen to you? You know that it is in the public interest that one man, one vote governs the country and we all get pushed around in various districts and live with an inordinate amount of uncertainty.

So I can tell you, having just finished redistricting, we just had our settlement, our consent decree, just got done in Colorado, I can tell you I understand completely your frustration and your quest for that kind of certainty so you can get on with the job. I feel exactly the same way and I couldn't agree with you more.

That's why we think, very expeditiously, that legislation ought to be passed, very clearly the public interest be defined, and we are trying to figure out what all those other subelements of that public interest are so that sound legislation can move ahead very quickly and we can get the kind of certainty that you want and that we want.

Mr. MacAllister. Well, I think when the plan is presented to the Justice Department, if it is approved, it gives a basis for starting to make that determination of public interest, and I don't know of anybody in the Bell system who feels that the Communications Act of 1934 should stand on the bucks.

Mr. **Wirth**. Exactly.

Mr. **Tauke**. Exactly.

Mr. **MacAllister**. It has got to be changed. Because that is the thing that is going to give us at least a step toward a degree of certainty and allow us to respond to your definition of public interest.

Mr. **Tauke**. Thank you very much.

Mr. **MacAllister**. Incidently, Congressman Tauke lost in this redistricting one of his most important constituencies when he lost Vinton.

Mr. **Tauke**. Thank you very much, Mr. MacAllister.

Our next witness is Andrew Varley, who is chairman of the Iowa State Commerce Commission.

Mr. Varley, I think that we may as well get underway. We do have a copy of your prepared statement and Congressman Wirth will return in just a second.

Why don't we get underway.

STATEMENT OF ANDREW VARLEY, CHAIRMAN, IOWA STATE COMMERCE COMMISSION

Mr. **Varley**. Thank you very much, Congressman Tauke.

We have filed some written comments on H.R. 5158, and we will respond to any questions that you might have.

We have not chosen to comment on the settlement between Department of Justice and A.T. & T. There have been all kinds of analyses of that done already, although some of my remarks may relate to that indirectly. I would say that we feel that it is very important for you to pursue legislation, that the national policy on telephone service should be set by Congress and not by the Justice Department and the courts. We feel you are on the right track with H.R. 5158. We do have some questions as to the specifics of the legislation. But we would hope that Congress would continue to pursue that.

I might just make a few observations about our general concerns. When we look at our present system, we have a great many very real advantages that we should not do away with. I think over the past many years we have had several things that really are nonexistent in the rest of the world. We have universal service, we have very reliable service and we have it at a reasonable cost. I think we should make a real attempt to retain this. We tend to take it for granted and there is no reason that it has to be that way.

When you see the kind of telephone service there is around the rest of the world, we certainly don't want to lose the advantages that we have. We get a little bit concerned when we look at the problem that is being solved. I think we accept the fact that there are going to be differences, changes, in the way telephone service is delivered, in the way it is charged for.

But when we look at the overall problem or fault or inequity that is trying to be solved, it is a little hard to find just what that is. I think it is important for Congress to try to analyze that and then look at the cost of solving that problem and also the advantages of preserving some of the good things that we do have.

I get rather disturbed when we hear repeated references to the subsidy of the full charges for local service and I am not here to say that the settlement agreements in the past have all been equitable or correct or shouldn't be changed. But to suggest that any money that flows from long distance calls to local services as subsidy, I think, is absolutely false. Certainly long distance service is useless unless you have the ability at both ends of that call, and to attribute that to a subsidy I think is wrong.

If you have suppliers, whether it be A.T. & T. or other competitive suppliers, that want to cost only their long distance service without picking up any of the cost for local service, I think they are really asking for a free ride. I think the policy of Congress should not let that happen.

Obviously we have had an opportunity to look at the comments that many other State regulators have made. We have received copies of their testimony and their letters and it would be very easy, I think, for Congress to get the impression that State regulators are primarily concerned about preserving their turf or protecting their territory. Let me say that that is not the primary motivation. State regulators today have plenty to do anyway.

But I think they have some very deep concerns about the cost for local service, the direction that we are going. I think they have the feeling that they are going to get a lot of credit for very high local service and have very little control over those costs that go into that. I think there is also a great deal of concern that once people start to experience those rapid runouts in local service costs, that the decisions will already have been made. That will all be behind us. Unless the general public becomes aware of what's happening, it is going to be too late to make any changes.

Obviously our basic concern is that if the cost for local service becomes so high, becomes so prohibitive that many people can't afford it, then we lose one of the real benefits of our present system. That is universal service. I think that we ought to make sure that that doesn't happen. We are concerned about a whole array of issues. We get the feeling that the local exchange companies that are under regulation may end up with an awful lot of obsolete equipment at a time when changes in technology have the potential for obsoleting a great amount of equipment.

Those are some of the kinds of concerns that we have. I think with that I will stop and respond to the questions.

[Mr. Varley's prepared statement follows:]

IOWA STATE COMMERCE COMMISSION
REVIEW OF H. R. 5158
TELECOMMUNICATIONS ACT OF 1981

Our review of H.R. 5158, known as the "Telecommunications Act of 1981," leaves us very concerned, specifically with the affordability and quality of telecommunications services.

Several specific provisions of H.R. 5158 are of concern to us. The access charges will be the crucial factor in determining how many consumers will find telecommunication services to be affordable. Therefore, the method of determining these access charges will play a critical role. Furthermore, we are concerned about other designated responsibilities of the 'Joint Transitional Board,' the development of Exchange Areas, the 'National Telecommunications Fund,' and the treatment of inside wiring and terminal equipment.

For the purpose of comment, the following categories have been isolated:

I. The Authority of the Transitional Joint Board and the Federal Communications Commission.

Under the provisions of H.R. 5158, a great deal of the authority presently held by the states will be assumed by federal agencies such as the Federal Communication Commission (FCC) and the Transitional Joint Board (TJB). Following the transition period, it would appear that the FCC will control the pricing and availability of telecommunication services, especially in sparsely populated areas which are not likely to receive any immediate benefits from competition.

We feel that the states, rather than the aforementioned federal entities, are best equipped to determine access charges and the valuation of assets. It makes little sense that federal agencies would have a better grasp of the communication needs or industry constraints of this or any other state.

These access arrangements are the most pronounced change in the regulatory 'status quo.' We believe that they are intended to replace the existing separations and settlement procedures and find no fault with the provisions in the legislation, (barring the need for greater specificity). However, we are concerned that the joint facilities be considered in relationship to the inherent engineering requirements of affected services so as to completely filter the local exchange from bearing costs related to the interexchange.

The TJB would be given the authority to establish the valuation of assets which are currently subject to the jurisdiction of the state regulatory commissions. Appeal procedures will be established for the FCC; however, the states have no recourse. There is no provision in the bill which establishes an appeal procedure for states. We believe that the states are closer to these issues and should have an avenue for appeal similar to that provided to the FCC. Fairness dictates an equal mechanism for the appeal of these decisions by the jurisdiction directly affected.

II. Exchange Areas.

We presently have several extended area service configurations, including some which cross state lines. As this bill lacks specificity, we are concerned that it may preclude this option. We would like these types of extended exchange access arrangements to be permitted under H.R. 5158. As such, we would request that language providing for interexchange and interstate communities of interest be inserted.

III. National Telecommunications Fund.

This would appear to be a mechanism to encourage connection of interexchange carriers and other customers with exchange carriers in situations where the costs involved would be more than 110 percent above the national average. As we interpret the wording of Section 234(b)(2), the "non-discriminatory " payments to this fund would be made by the interexchanges and customers who are interconnected with the exchange carrier. Referring to Section 234(b)(1), it would appear that to some extent, the level of these "non-discriminatory" payments would be determined by the amount adjudged by the TJB for the National Telecommunications Fund.

The goal of the fund is to relieve the exchange ratepayers and those who pay access fees of the burden of costs exceeding 110 percent of the national average (Section 234(b)(1) lines 9-11). This could tend to shift the burden of costs to the interconnected interexchange carriers and customers not necessarily in proportion to the "above average" costs they caused the exchange carrier to incur. Also, the service standards and required exchange offerings differ from state to state (e.g., mandated Emergency 911), as do costs for similar levels of service provided. The funding criteria based upon deviations from the average appears inappropriate. We believe further clarification of the basis for funding the National Telecommunications Fund and the specific methodology for obtaining that funding is required.

As we interpret the National Telecommunications Fund provisions of H.R. 5158, it is intended to provide a uniform level of charges for service by exchange carriers through cross-subsidization payments provided by those who utilize the services. Even though the charges imposed by the exchange carriers could be relatively uniform, the actual payments made by the customers utilizing those services could conceivably differ dramatically.

As stated previously, the relative cost of service of an exchange may vary by virtue of inherent engineering standards and/or service enhancements. As such, the 110 percent provision may be inappropriate. If the intention is to stifle some of the adverse effects of the bill, it is recommended that the National Telecommunications Fund be allocated on the basis of impact. This would be done by equalizing the resulting percentages of increase as opposed to the average costs affecting exchange rates. This method would still reflect relative cost responsibilities and offer a more equitable form of subsidy.

IV. Inside Wiring and Terminal Equipment.

As we understand this section, it essentially provides that after the effective date of this act and rules prescribed by the FCC, regulated carriers must separately bill for terminal equipment that was in place prior to the effective date of the act. Carriers would no longer be able to charge for providing terminal equipment or include any associated costs in their tariffs subject to certain somewhat ambiguous exceptions. Two years after effective date of the act no terminal equipment shall be offered under tariffs or included in the rate base of any regulated carrier. (Emphasis added).

The customers may purchase terminal equipment which is not fully depreciated at a price fixed by the State commission. When the State Commission determines terminal equipment to be fully depreciated, it may become the property of the customer utilizing it or the Commission may elect to allow the carrier to retain ownership or otherwise dispose of it, if the equipment is not in use.

We are quite concerned in view of the foregoing, that the states may have some alternative treatment options for terminal equipment which might be preferable to those proposed by H.R. 5158 and as such, these provions may tend to stifle consumer-oriented provisions better geared to the particular state. Furthermore, the hard and fast provisions concerning inventories of spare parts may be in the long run more burdensome than beneficial relative to the public's interest. If there is a demand for these parts, could this not be provided for by the non-regulated sector or by some other means which would more closely teach the economic life of the terminal offerings in question.

Concerning inside wiring, we find that there is a preclusion of some of the various alternatives available to the states that may be preferable to that specified in H.R. 5158. The bill mandates that regulated exchange carriers shall continue to offer inside wiring on a regulated basis during the five year period following the effective date of Section 272. This could be continued based on subsequent FCC determination. Furthermore, we are concerned as to the extent of regulation over inside wiring as it is not implied nor are options available to the states contained in H.R. 5158.

V. Summary.

We wish to summarize and reiterate the following areas of conern:

A. The State regulatory commissions will lose a great deal of jurisdictional authority over the telecommunications industry. Some aspects of the current transition in this industry are better suited to regulation (or deregulation) at the state level.

B. The FCC and TJB will be required to enact a great number of rules and regulations, organize and institute the National Telecommunications Fund, determine the value of assets of regulated carriers, and assume other responsibilities as well as monitor and process the various reports, tariffs and activities of the carriers.

C. In many areas, only a few discussed here, of H.R. 5158, clarifications are required and specific procedures need to be expanded upon.

D. We believe that while the goal of this act to provide for universal service, increased competition in telecommunications, the best quality equipment and service at the lowest possible cost, fair, non-discriminatory rates, and cooperation between the Federal Government and the States, as well as other stated purposes, is a worthwhile objective, passage of this act into law in its present form may very well defeat the purposes for which it is intended.

E. We find H.R. 5158 to be more representative of the public's interest than those provisions espoused in S. 898.

Mr. **Tauke**. Thank you very much.

Congressman Wirth.

Mr. **Wirth**. Thank you, Mr. Tauke.

Mr. Varley, I am delighted to have you here and you all and the State public utilities commissioners, I have enormous sympathy for. I always think that we have the worst job until I think about the job that you have to do every time that natural gas rates go up or there is a boycott of oil in the Middle East and energy prices go up. You are all the people that catch it in the neck as if it is your fault. The same thing can happen here, as you point out, I think.

The concern that you register primarily is how to buffer people against a very rapid increase in rates. The purpose of buffering people against that is not only the cost factor, but maintaining universal service so that everybody can afford telephone service. That is issue number one, and second, that that service be of real quality and continue to upgrade and not have the kind of outmoded equipment left in the local operating companies that you were suggesting earlier.

At the time that the settlement was announced, I believe on the 8th of January, there was a statement by A.T. & T. offices all across the country that rates were going to go up very dramatically as a result of the settlement. In my own area of Colorado Bell and Mountain Bell, the statement was made that rates would go up from $8 to $18 a month. That of Ohio Bell was quoted as saying that rates would go up two or three times. The head of New York Tel was quoted as saying that rates would at least double. The president of A.T. & T. was quoted as saying that rates would go up very dramatically as a result of the settlement.

A few days later all of that stopped very quickly all the way across the country, as if somehow a directive had gone out saying, "Hey, you guys stop saying that. Don't say to the public anymore that rates are going to go up in this way."

Do you think that unless Congress acts, that there is a rationale for rates going up as dramatically as Bell executives all across the country have said they would? If so, is there a justification for rates going up so dramatically?

Mr. **Varley**. I don't think there is any question but what we would experience that kind of a runup if it goes through the way it is being discussed. I don't think there is justification for it. I think when you talk about protecting the local exchange service, it is more than just trying to protect local rates to hold them down. I think it is a matter of equity. I think there is a real error in assuming that long-line service should not bear part of the cost for that local exchange. That has been a public policy for decades and to say now that that no longer makes sense as public policy is a little beyond me.

I think it is clear how that has developed over the past few years, primarily from activity in the courts and the Justice Department, that somehow there is a public benefit to this competition on long-line service which may or may not be the case. It is just that long-line service should bear all the cost. Certainly if in dividing up this property we say to the local exchange companies, they take all of the equipment, all of the obsolete equipment, they take all of the accounts that will be accumulated over a period of years, and that

A.T. & T. then can compete with MCI and other long-line providers only on new costs, only on operating costs, I think is really to ignore the fact that they have to have access to that local exchange.

Any time that you have a service, a question of costing for a variety of services where you have shared plant, there is a subjective judgment about who should bear the cost and share the cost. We are kidding ourselves if we don't accept the fact that that's a judgment call, a subjective judgment call, and that should be manipulated to accomplish public policy. There is nothing magic about accounting or economics to say that so much of that charge has to go to this part. Certainly, there is a real inequity if we say all of the charge has to go to the local regulated service.

Mr. **Wirth**. In talking about buffering, it seems to me we come back to the contributions that are made, you know, to the local rate base and those contributions come from a variety of sources. We have talked about yellow pages. We haven't talked about equipment but there is a major contribution that is made from the equipment percentage of long distance calls that come in and there is a long distance contribution that is made to local rate base and then there is the whole question of asset evaluation.

Maybe I could run through those very quickly if I might.

What is your position on yellow pages? Do you believe that yellow pages ought to go to the parent company or should that stay in the local rate base?

Mr. **Varley**. We feel that should be part of the local exchange. That has been a good revenue producer but as a practical matter, that is unique to that telephone company. I don't see how it is competitive. I just think it makes sense to leave it with the local exchange.

Mr. **Wirth**. We talked about the equipment, itself, under the settlement, the equipment over an 18-month period of time, all equipment that people now in the State of Iowa have that is Bell equipment, would be transferred to the parent company. We have been trying to figure out if that should happen or if that equipment should stay again in the local operating company, in the local rate base. What is your opinion about what we should do with current equipment?

Mr. **Varley**. You are talking about terminal equipment?

Mr. **Wirth**. Terminal equipment.

Mr. **Varley**. I think the terminal equipment may very well be a real competitive market as other suppliers develop the capacity to produce more equipment. I think that can become very competitive even though Western right now is certainly the major provider. I think that perhaps that can become competitive and the terminal equipment can be separated out rather easily from the regulated portion of the company.

I guess the question that we have is how do you handle that. If all the equipment goes, then the bad accounts should go along with the good accounts. There can be a real temptation to write off anything that's obsolete with the local exchange company while A.T. & T. gets to keep all the new equipment, what is just coming out of manufacture.

A good example of that is the inside wiring question. That whole account represents primarily time and labor and has built up over a number of years. As I understand it, the agreement said that the local exchanges can't own any of that inside wiring or terminal equipment, which is fine. But A.T. & T. should take their share of that account that accumulated over a period of years; not say: "Well, we will own the terminal equipment, the inside wiring, but the regulated company gets to keep that large account and amortize that out."

Mr. **Wirth**. Let me ask you a very specific question related to Iowa on that front.

If new terminal equipment, as you are suggesting, is probably competitive, the issue is what do we do with all the equipment that is now in people's houses? Let's take an example: If you are a homeowner in Mount Vernon, Iowa, and you have a telephone in your house, right, and you are a subscriber of Northwestern Bell. I think that that goes to Mount Vernon, is that right? Under the settlement, that piece of equipment would transfer to the parent company. It is now the middle of January 1985, and your telephone stops working. You are a householder in Mount Vernon, Iowa. Do you call Northwestern Bell to get that piece of equipment fixed or do you call somebody from A.T. & T. and do they have an office to come in and fix that piece of equipment? Do you have any sense of how that would be handled?

Mr. **Varley**. That is a real concern to us. I think we visualize the company is providing that service on a voluntary basis. That if, in fact, the Northwestern Bell wants to provide and repair service on a time and materials basis, that we would allow them to do that. That is certainly the way we plan to handle other telephone companies other than Northwestern Bell.

I suppose they would have a choice of hiring some local repairman if there was one, going to the local J. C. Penney's store and buying a new phone or something of that nature. We are not so concerned with Mount Vernon as we are with some of the very small towns where there literally may not be anyone within 50 miles that can really do repair service. And we think there is possibly a real void there where we really haven't taken care of everything. If we prohibit Northwestern Bell from doing that type of thing, there would be no real recourse for the customer.

Mr. **Wirth**. Thank you, Mr. Tauke.

Mr. **Tauke**. Following up on that same question, suppose you are experiencing phone difficulty in 1985 or 1986, after all this goes into effect, you call up the local telephone company and the local telephone company might say: "Well, it is not our problem. It is in your inside wiring." You call up somebody to repair that and they say: "Well, it is not that problem; it is in the telephone." Or maybe, if you were making a long distance call, you call up the phone company and they say: "Oh, well, it is those long lines that A.T. & T. or MCI or somebody is providing."

How do we insure that there is some accountability, in a sense, for service in a system that is fragmented like this system may be?

Mr. **Varley**. I don't think that we can. And that is one thing that is of real concern to me. Under the old system, if anything wasn't working, we'd call the telephone company and ask them to fix it and that was the last call you had to make, presumably; that they would go out and check the whole system if things were breaking down and not working properly.

I don't know that with the competition in terminal equipment we can solve that problem. I don't know if there is any good answer. I think that the nature of the business has developed over the past few years to where there is very little choice. Certainly people now are buying telephones at K-Mart and wherever else they can find them. And take their chances.

Mr. **Tauke**. What should we do with the inside wiring? Do you have any feeling about that?

Mr. **Varley**. Under the draft of this proposal we put serious constraints on the States for resolving that issue. I will tell you how we are trying to resolve it in Iowa. We have said that the companies will come in and on all new installations charge for that on a time-and-charges basis or else let someone else do it, but the company owns the wiring up to the block from the outside of the house, the protector, but those people own all their inside wiring in a new home.

On the old homes, they don't have the option of purchasing that back or paying off their share of the account; that over a period of years that account will depreciate out and be gone. And from that point on, all the homeowners would own their own inside wiring. They would not have a share of that account.

We are particularly troubled by the reference to that account as inside wiring because it includes so many other things. A lot of that is a trip out and the time spent connecting it up. We have attempted to split out the account between the drop service from the main line up to the house and then from the house to the telephone, so that the regulated company still has that line from their main line up to the house.

I think it is unfortunate the way that account built up over the past several years. I think there is no equity, though, in continuing to let that accumulate.

Mr. **Tauke**. Is there anything that we should be doing legislatively in that area or should we just kind of let it sit?

Mr. **Varley**. I think you ought to leave that up to the States to handle that pretty much the way they want to unless you get the feeling that there is some gross inequity developing somewhere.

Mr. **Tauke**. In the exchange areas, do you feel comfortable allowing the Bell System to determine what the exchange areas will be in a State like Iowa?

Mr. **Varley**. No, not the Bell System, not the FCC. We feel that the States should have some jurisdiction there, as well. I guess we are concerned—well, we have instances where the extended area service would overlap State boundaries. And that, as I understand it, in the legislation would be prohibited. Certainly in the Davenport area, Omaha-Council Bluffs area, that creates a real problem.

We would like to have flexibility in the future for making determinations between extended area service or whether we have measured service of some type. In having specific legislation we tend to limit our options in trying to decide what would make the most sense for a local community.

Mr. TAUKE. There has been some speculation that if we left that to the States without some kind of control, that the State of Iowa might decide we'd have three local exchange systems, the three area codes. Is that in the cards or is that something that is just totally unrealistic?

Mr. VARLEY. I don't think it is in the cards but would that be any disaster if the State regulators decided that that would be a good idea?

Mr. TAUKE. I don't know that it would.

Mr. VARLEY. If that seemed to be the cheapest way to provide adequate service within an area. I assume that if the state regulators did that, it would be for a good reason.

Just offhand, I don't think there is a good reason. I don't think we would want to do that. But I am not sure that Congress should decide that they can't do that.

Mr. TAUKE. In H.R. 5158, there is some considerable transfer in the sense of regulatory responsibility from the State and public utility commissions to the FCC, especially as it relates to independent companies. I know a number of the independent companies, and I suspect they will be telling us in a few minutes, are concerned about this. Do you believe that the public utility commissions at the State level can continue to adequately represent the local companies, what is the interest of the Federal Government in this? How do you define where that interest should begin and end?

Mr. VARLEY. Well, I think that the State regulators not only do a better job of taking care of local companies' interests but I think the local ratepayers' interest, as well. Certainly, when we make policy, we hold public hearings off and on in the small communities that are affected. Those people, if they have a problem, come to us and we try to hear them. And if there is a reasonable solution, we find that solution.

I think transferring that responsibility to the FCC means that some faceless bureaucrat in Washington is going to make decisions that have significant affect on local people. They feel like they have no recourse, no real voice.

Mr. TAUKE. Do you think you can set the access fees for all of these independent companies?

Mr. VARLEY. We are very concerned about access fees because that is really the key to what local service is going to cost. I am not sure it is adequate to say that, "We will let you set access fees within the State. All interstate calls will be strictly on a competitive basis and FCC will set those at a very low rate."

Certainly for a rural State like Iowa, and I assume some of the same would be true for Colorado, that it is interstate calls that generate a large amount of revenue. And appropriate access fees for interstate calls have got to be just as important, if not far more important, than access fees for the intrastate long distance calls.

I guess if we felt that those fees would be set at what we consider an equitable level, we wouldn't be so concerned. I think FCC will be under a lot of pressure to keep those access fees very low, to keep the cost of tolls very low, and let the real cost fall back on regulated exchanges.

Mr. TAUKE. Now, just a couple of questions on rates: If we don't do anything, do you have any ability to project what the local rate increase would be for Iowans?

Mr. VARLEY. We haven't done any formal study, but just the general projections we have made, we would anticipate the local service would cost anywhere from two to three times what it costs today.

Mr. TAUKE. Two to three times what it costs today. Is that over a 1-year, a 2-year, a 3-year period, or as a result of the consent decree?

Mr. VARLEY. It would be as a result of a combination of things. I think the consent decree tends to formalize the direction that the FCC in earlier settlements was going anyway. Certainly that's the major factor.

Mr. TAUKE. Under those circumstances, there undoubtedly would be a lot of pressure on public utility commissions such as the Iowa Commerce Commission, to hold those rates down.

Does that potentially threaten the viability of the local operating company?

Mr. VARLEY. Well, to the extent that if they respond to local pressures so much that they went below the company's—anywhere close to an equitable return on their investment, it could jeopardize their existence. I don't anticipate that happening. I think the State regulators that I am familiar with understand the need for keeping some return.

I guess our primary problem is if that cost becomes very high, plus the social cost that goes with it, you have people with modest incomes would decide they just can't afford telephone service anymore, you have older people that really depend on the telephone as their access to the outside world for all practical purposes, suddenly finding that cut off, that's a luxury they can no longer afford, I think that is a very high social cost that we should be very reluctant to accept.

Mr. TAUKE. How should we proceed in the evaluation of the assets of companies with respect to companies as we go through this splitting process?

Mr. VARLEY. I guess it is going to sound self-serving but I think we would feel State regulators ought to have a voice in that.

Mr. TAUKE. How significant is this in terms of the overall scheme of things, future rates? Is it fairly critical?

Mr. VARLEY. Well, it can be critical. I think those assets would be pretty much depreciated at book value, as we have in the past. I think we are more concerned which company gets which assets and which obligations. We see the potential for the local regulated companies to be a real dumping ground. If that happens, it is going to be disastrous in terms of local rates.

Mr. TAUKE. Mr. Wirth, any further questions?

Mr. WIRTH. A couple of points of clarification. You and Congressman Tauke had quite an exchange about the jurisdiction of the State PUC's versus the FCC, the Federal/State system. And there is in here, of course, a balance between having a national communications network and local responsibility responsive to local needs.

The three points on the definition of exchange areas, the legislation, H.R. 5158, provides that you all would be the individuals determining the local exchanges. I just want to make that point and I am not sure that that had been made clear in the discussion.

Second, in talking about jurisdiction over independent telephone companies, there was some ambiguity in H.R. 5158 on that front, and we have been working with the independents to make sure that there was language at the front of the bill and language at the back of the bill that could be interpreted as giving the FCC jurisdiction over those independent telephone companies, and we have worked that out and we will have that handled in a package of technical amendments that will be offered. And the independents have been in as well as representatives of NARUC.

Third, on the access charge issue, and we have talked about how much is going to be charged for the long distance to plug into the local loop, to have access to the local loop, we have had a lot of discussions about who does what in determining that set of charges and then administering that set of charges. And we have in H.R. 5158, as you know, a joint board of FCC Commissioners and State PUC people to look after both that national interest and that local interest. We have had a lot of discussions with NARUC about continuing that, not in just a transitional period, but continuing it permanently so that we continue to have that balance there between what is in the concerns of one State, Iowa, or one State, Colorado, and what is also a national concern to make sure we have that national network, again that kind of balancing.

But I want to thank you for being here and your fellow commissioners across the country who have been very, very helpful to us in helping to sort out the problem of, you know, this is federalism. We hear a great deal about federalism from our President. I mean this is federalism in communications and where is the national interest and where is the State and local interest. And how do we sort that out, and you all have been very, very helpful to us in working that out in H.R. 5158 and its subsequent legislation.

So I thank you very much and ask you to thank your fellow commissioners and thank you for being with us today.

Mr. VARLEY. Thank you.

Mr. TAUKE. Our next witnesses represent small independent telephone companies. The first is Ken Lein, first vice president of OPASTCO, the Organization for the Protection and Advancement of Small Telephone Cos.

Ken is from Lake Mills, Iowa.

Howard Sorenson, president, Iowa Telephone Association, from West Des Moines, Iowa, and Curtis Olson, general manager of the Cascade Telephone Co. in Cascade, Iowa.

As you know, we do have copies of your prepared testimony. We hope that you will choose to summarize that as much as possible so that we can hold the length of the testimony down and get to the questions.

Thank you very much.

STATEMENTS OF KENNETH LEIN, FIRST VICE PRESIDENT, ORGANIZATION FOR THE PROTECTION AND ADVANCEMENT OF SMALL TELEPHONE COS.; HOWARD SORENSEN, PRESIDENT, IOWA TELEPHONE ASSOCIATION; AND CURT OLSON, GENERAL MANAGER, CASCADE TELEPHONE CO.

Mr. LEIN. Mr. Chairman, members of the subcommittee and staff, I am Kenneth Lein, general manager of the Winnebago Co-op Telephone Association with offices in Lake Mills, Iowa, an independent cooperative serving 5,000 customers in 17 rural exchanges in northern Iowa.

I am first vice president of Organization for the Protection and Advancement of Small Telephone Cos., known as OPASTCO, which represents 400 independent telephone companies, serving nearly 1.5 million customers across the Nation.

I am pleased to have this opportunity to appear before you in regard to H.R. 5158, the Communication Act of 1982, and to state my perceptions of the settlement of the Justice Department's antitrust suit against A.T. & T.

Member-owned and controlled cooperatives like Winnebago resolved years ago to finance, build and maintain for themselves a communication system at a time when no one else was interested in providing service to our service area.

An unwise or uncautious choice by either the FCC or legislators threaten rural rates and services and the existence of hundreds of small telephone companies.

Rural telephone companies are trying hard to better understand the appropriate role for competition and regulation in telecommunications.

Costly regulations of small telephone companies should be streamlined and kept to a bare minimum. Since Iowa companies are regulated as to quality of service, there is no public demand for rate regulation.

Where can justification be found for rate hearing procedures that will tend to increase rates to customers, force small telephone companies to employ high-priced personnel, certified public accountants, engineers, attorneys with rate case experience? In 1981, the exemption from rate regulation was raised from 2,000 to 15,000 stations in Iowa. And recently the State of Minnesota exempted companies under 2,500 stations and a handful of other States have concluded that member-owned and controlled cooperatives should be exempt from rate regulation by State commissions.

I believe that this is a correct and responsible governmental action and I urge Congress to take bold steps in this direction.

Rural consumers have historically been underserved from both an entertainment and a nonentertainment communications standpoint. Small companies must be permitted to extend and expand their revenue potential in the face of competition and diminishing support from toll.

Coaxial cable and fiber optic will in the future prevent both telephone and video transmission over the same facilities, thereby we can efficiently utilize both plant and personnel to help keep service and keep rates down. If small telephone companies are permitted to make such investments, low-density areas will be able to economically participate in the telecommunications technology revolution, especially where these systems can use existing offices, existing billing and collection systems, and personnel and equipment to eliminate additional costs.

I do not believe that it is in the public interest to perpetuate a ban against companies offering CATV services. It is simply wrong to relegate telephone pioneers to an obsolescent technology. Furthermore, the ban is anticompetitive and an encroachment on the legitimate prerogative of local franchising bodies.

Consequently, I urge that section 264, the codification of this ban, be eliminated.

It is interesting how much has been said following the settlement of the Justice Department/A.T. & T. suit about skyrocketing increases in local service rates that will occur.

For one, I believe that there will be some rate increases, but I don't think that the cause is because of the settlement. Rather, I think the cause will be mainly from the fallout from competition in the intercity communication routes, the deregulation of terminal gear, the inflation and anticipated loss of support from the toll for the local exchange that will eventually force rates up.

To assist this important legislative proposal, designed to keep local exchange services universal and affordable, OPASTCO and the rural telephone coalition has commissioned a report on the operation of the 110-percent mechanism in conjunction with the operation of the National Telecommunication Fund, [NTF], as described in section 234 of H.R. 5158. And I am pleased to provide copies of these reports for the record and to assist the staff.

I think that there will be significant transitional costs and confusion if the joint transitional board is first established and then phased out in the short 5-year period, with the FCC taking over that function after that, as I understand it.

Rather, I believe that the transitional joint board should have a longer life and it should have a longer lease on life than the 5 years.

In conclusion, I urge that legislation insure that rural telephone companies be permitted to provide cable television service in our service area, that the surcharge on the access charges will cover the increased costs for providing exchange service in high-cost, low-density areas, that the NTF will protect rural telephone systems against the possibility of higher rates if the toll rates are deaveraged. And removal of new regulatory burdens on small telcos by legislating the present 2(b)(2) filing exemption that now exists. Realizing that rural areas can better be served by regulation at the State level than at the Federal level because each State has a unique problem that can best be addressed by people closest to those service areas.

I commend you and your staff for the thoughtful approach you are taking to this most difficult legislative area. We know you care about rural Iowa and rural America and do not want to take any action that will diminish the existing levels of rural telephone service.

H.R. 5158 is a major step in that direction and I wish to thank you for this opportunity to appear before the subcommittee on behalf of OPASTCO.

Thank you.

[Mr. Lein's prepared statement follows:]

TESTIMONY OF
KENNETH LEIN
LAKE MILLS, IOWA

On the Telecommunications Act of 1982
and the Anti-trust Settlement Between
Department of Justice and AT & T

In behalf of the
ORGANIZATION FOR THE PROTECTION AND
ADVANCEMENT OF SMALL TELEPHONE COMPANIES
Before the House Subcommittee on Telecommunications
Consumer Protection and Finance

February 11, 1982

Mr. Chairman, members of the subcommittee and staff, I am Kenneth Lein, General Manager of the Winnebago Cooperative Telephone Association, with offices in Lake Mills, Iowa, an independent cooperative company, serving 5,000 customers in 17 rural exchanges in North Central Iowa. I am the First Vice President of the Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO), which represents 400 independent telephone companies serving nearly 1.5 million customers across the nation.

I am pleased to have this opportunity to appear before you in regard to H.R. 5158, "The Communications Act of 1982", and to state my perceptions of the settlement of the Justice Department's anti-trust suit against AT & T.

Small, rural telephone companies serve over 50% of this nation's geographical area. We are proud of the efficient, modern, consumer-oriented telecommunications service we are presently providing our nation's rural areas. Member owned and controlled cooperatives like Winnebago, resolved years ago to finance, build and maintain for themselves, a communication system at a time when no one else was interested in providing telephone service to our area.

We are very concerned about the affects of existing and future federal regulation on our systems. An unwise or uncautious choice by either the FCC or legislators threatens rural telephone rates and services and the existence of hundreds of small, rural telephone systems.

Rural telephone companies are trying hard to better understand the appropriate role for competition and regulation in rural telecommunications, and legislation that promotes competition must provide a minimum of rate disparity between urban and rural, if universal service at reasonable rates is to continue for companies in high cost, low density areas.

Costly regulation of small telephone companies should be streamlined and kept at a bare minimum. The State of Iowa became a leader in deregulation when, in 1963, the Code of Iowa was amended to exempt mutuals, cooperatives and companies with less than 2000 stations from rate regulation by the Iowa State Commerce Commission.

Public rate hearings are expensive and small telephone companies must spread the cost to a relatively small number of customers. Since Iowa companies are regulated as to quality of service, there is no public demand for formal rate regulation.

Where can justification be found for a rate hearing procedure that will tend to increase rates to customers, force small telephone companies to employ high priced professionals, certified public accountants, engineers and attorneys with rate case experience. In 1982, the Iowa exemption from rate regulation was raised from 2,000 to 15,000 stations. Recently, the

State of Minnesota exempted companies under 2,500 stations, and a handful of other states have concluded that member-owned and controlled cooperatives should be exempt from rate regulations by state commissions. I believe this to be a correct and responsible governmental action and I urge Congress to take bold steps in this direction.

OPASTCO's members are proud of the communication services they have brought to their customers in the past, and are vitally interested in continuing to offer broad band services and the full range of new, sophisticated services along with traditional voice services at affordable rates.

I believe ratification of these basic concepts is at the heart of H.R. 5158 and to that end, I support it. However, in conjunction with the Rural Telephone Coalition (RTC), comprised of OPASTCO, NTCA and the National REA Telephone Association, I believe a number of amendments to the basic legislation are warranted in the public's interest.

Rural consumers have been historically underserved from both entertainment and non-entertainment communications standpoint. Fortunately, this rural enviornment is benefitting more and more from advanced technologies such as digital switching, satellites and video. Therefore, we believe this new enviornment should be promoted through enlightened legislative and regulatory policies that allow rural telephone companies more opportunities to offer evolutionary services.

Small companies must be permitted to expand their revenue potential in the face of competition and diminishing support from toll. This means small companies must look for additional revenues within their exchange area through marketing new services. Cable providers have concentrated on core areas and have not sought to offer cable service to remote or sparsely populated rural areas which may, thereby, be deprived of broad band services well into the future. Co-axial and fiber optic cable will, in the future, permit both telephone and video transmission over the same facility, thereby efficiently utilizing both plant and personnel to keep local service rates down. If small telephone companies are permitted to make such investments, low density rural areas will be able to economically participate in the telecommunication technology revolution, especially where these systems can use existing offices, billing and collections systems, and personnel and equipment to eliminate additional costs.

I do not believe that it is in the public interest to perpetuate a ban against telephone companies offering CATV services. It is simply wrong to relegate telephone pioneers to an obsolescent technology. Furthermore, the ban is anti-competitive and an encroachment on the legitimate perogative of local franchising bodies. Rather, I advocate that the broad band cable market be open to all. In this way, new broad band interactive services will be promoted for the benefit of consumers. Consequently, I urge that the Section 264, codification of this ban, be eliminated. The CATV industry does not need or deserve political protectionism. It is simply not fair for the major CATV multi-system operators to be able to compete with telephone companies for local exchange traffic, while at the same time, telephone operators are restricted in their efforts to compete for broad band services.

It is interesting how much has been said following the settlement of the Justice Department/AT & T suit about skyrocketing increases in local service rates that will occur. A number of state regulators and some telephone company executives also have forecasted substantial rate increases due to the AT & T settlement. For one, I don't believe that the settlement, in or of itself, will cause such increases. Rather, the fallout from competition in intercity communication routes, deregulation of terminal equipment, inflation and anticipated loss of support from toll for the local exchange could force rates up in any event. That is why an equitable system of access charges in conjunction with a legislative provision to keep local rates and toll below 110% of a national average is needed. Such a concept was contained in H.R. 6121 as reported out by the House Commerce Committee in 1982. A similar concept was contained in S. 898. And now, H.R. 5158 seeks to implement this new industry mechanism.

To assist this important legislative proposal, designed to keep local exchange services universal and affordable, OPASTCO and the RTC commissioned a Report on the operation of the 110% mechanism in conjunction with the operation of a National Telecommunication Fund (NTF) as described in Section 234 of H.R. 5158. I am pleased to provide copies of this Report for the Record and to assist the staff. I might add, that in contemplation of divestiture of the Bell Operating Companies, the need for a new national institution to reform AT & T division of revenues process and the separations and settlements process and to implement a nationwide system of access charges for all intercity users of local exchange plant -- including due compensation for non-traffic-sensitive portions of plant -- is needed.

I have some administrative concerns related to Section 273 of H.R. 5158. I think that there will be significant transitional costs and confusion if a Transitional Joint Board is first established and then phased-out after five (5) years, with the FCC taking over the function. Rather, I believe that the Transitional Joint Board should have a longer lease on life than just five (5) years, or the FCC should operate under its present Section 410 to promulgate universal access charges and retain authority to modify them as required in conjunction with the 110% provision.

In conclusion, I urge that legislation ensure:

- Rural telephone companies be permitted to provide cable television service in their service areas.
- That the surcharge on the access charge will recover increased costs for providing exchange services in high cost, low density areas.
- That the NTF protects rural telephone systems against the possibility of higher rates if toll rates are deaveraged.
- Removal of new regulatory burdens on small telcos by, legislating the present small carrier 2 (b)(2) filing exemption. Realizing rural areas can be better served by regulation at the state level than at the federal level. Each state has unique rural problems which can best be addressed by people closest to those areas.

I commend you and your staff for the thoughtful approach you are taking to this most difficult legislative area. We know you care about rural Iowa and rural America and do not want to take any action which will diminish the existing levels of rural service. H.R. 5158 is a major step in that direction.

I want to thank you for this opportunity to appear before this subcommittee on behalf of OPASTCO.

Mr. TAUKE. Thank you very much, Mr. Lein.

Our next witness is Mr. Howard Sorensen.

STATEMENT OF HOWARD SORENSEN

Mr. SORENSEN. My name is Howard Sorensen and I manage the Marne and Elk Horn Telephone Co. at Elk Horn, Iowa, which is in the southwestern part of the State. We serve a total of 1,406 stations.

I represent the Iowa Telephone Association here today. I am serving as president of the Iowa Telephone Association, and I have been a director of this association since 1970.

Curt Olson, who will follow me, is also a board member of the Iowa Telephone Association. Curt is from Cascade.

All the members and directors of the Iowa Telephone Association are extremely pleased to have this opportunity to appear today to discuss legislation restructuring the telecommunications industry, as well as the A.T. & T. antitrust settlement.

Iowa's telephone industry is unique in that we have 161 telephone companies in the State with at least one or more exchanges. All of the 161 operating companies, from the largest, which is Northwestern Bell, to the smallest, which is the Miller Telephone Co., belong to the Iowa Telephone Association.

There are about 1,480 total companies in the United States. Almost 11 percent of all the independent companies in the United States are in Iowa and the average size of the independent company operating in Iowa is much less than in any other State. I think that figures out to about 1,656 average stations per company.

We have six companies in the State of Iowa with less than 200 stations and 100 with less than 1,000 main stations. There are only five companies in the State of Iowa with over 5,000 stations: Central Telephone, Continental Telephone, General, Northwestern Bell and United.

Iowa's also unique in its regulatory law for telephone companies. The Iowa State Commerce Commission was given the authority to regulate rates, charges and services of the telephone companies back in 1963. At that time, the Iowa Legislature recognized the cost and affects of regulation for small companies and exempted from rate regulation all cooperatives, mutuals having at least 50 percent of their users as owners, and all companies with less than 2,000 main stations.

In 1981, the Iowa Legislature amended this law to exclude from rate regulation all companies with less than 15,000 main stations. Today, the Iowa Commerce Commission regulates the rates of only five telephone companies. All 161 companies, however, are service regulated and subject to the service rules of the commission.

This move to deregulate small companies by state legislatures is growing. Minnesota has deregulated cooperatives and companies with less than 2,500 main stations. And we understand that the Minnesota Legislature is giving consideration to raising the exemption to a larger figure, also.

Nebraska and Missouri are also considering legislation to deregulate smaller telephone companies.

We have about eight different comments we would like to make in regard to the bill. The first concern we have is about section 226, which deals with the filing of tariffs with the FCC. This is contrary to the actions by our State legislators to deregulate telephone companies and it would result in a great deal of cost to companies that we feel in reality is needless.

Our second item covers Federal and State regulation. Section 211, together with 301(29) appears to give the FCC authority over all activities of the telephone company. All Iowa customers can now own their terminal here if they so desire to and will soon be able to own the inside wiring.

This additional authority for the FCC would seem to eliminate the need for the Iowa Commerce Commission. If we are to have regulation like this, we prefer it should be from our State of Iowa, rather than from the Federal level.

Our third item regards customers owning equipment. Section 272 talks about customers purchasing terminal equipment from a company and the customer taking ownership of fully depreciated equipment. It also talks about a public auction of used equipment, possibly by the Iowa Commerce Commission. We are opposed to this section. We feel there are places already who handle used equipment and we are not totally clear as to the meaning of this section.

Item No. 4 deals with the Transitional Joint Board. Section 273 establishes the Transitional Joint Board which will administer the National Telecommunications Fund. We feel that this fund should be administered by industry representatives rather than by commissioners, much as it is now, with an overview by the FCC.

Item No. 5 addresses universal service at reasonable rates. And section 234(b)(3) talks about universal service at reasonable rates. The Iowa Telephone Association recognized the need for subsidies of high-cost, low-density rural areas and passed a resolution on October 20, 1981, for consideration by the Federal/State Joint Board. A copy of that is attached to the information that was sent you.

This subsidy should be by the size of exchange, not by the total number of telephones served by a carrier in all exchanges.

Item No. 6 regards the funding of intervenors' activity. Section 282 provides for funding of the intervenors' activity.

The Iowa Telephone Association opposes this type of activity in the Iowa Legislature because it seems unfair to use company revenues to oppose the company, itself.

We feel such groups should be funded by voluntary funds.

Item No. 7 regards cable television. Exclusion by section 264(b)(1) against the provision of cable television we feel does not need to exist by law. There is no reason to exclude telephone companies unless it is to protect the existence of a monopoly for cable television operators. If we can compete in this area, it will hasten cable television to rural areas that are not presently served.

On the item of the A.T. & T. divestiture, we were asked to comment on this. Our main concern is what regulations and laws are passed as a result of this and at this point we feel that there are many questions that remain unanswered in this area.

In summary, the Iowa Telephone Industry is concerned about universal service at unreasonable costs as are all of our customers. Iowa is basically rural. We have seen deregulation of trucking and airlines and what that is doing to the State of Iowa. We have seen airline carriers pull out of cities such as Fort Dodge, Dubuque, Burlington and Ottumwa. We don't want long distance toll carriers to pull out of markets in small communities in Iowa. Long-line carriers must have clear instructions to maintain and utilize the existing network. Protection must be provided so that a total network is continued to provide access into and out of rural homes and businesses through the local exchange.

It would be traumatic if the toll carriers are allowed to pull out of markets or provide a direct toll connection to a large company and ignore the small company.

Thank you for this opportunity.

[Mr. Sorensen's prepared statement and attachment follow:]

IOWA TELEPHONE ASSOCIATION
COMMENTS ON HR5158

My name is Howard Sorensen. I am manager of the Marne & Elk Horn Telephone Company of Elk Horn, Iowa. We have four exchanges and a total of 1406 main stations. I started with this company twenty-five years ago. I have been manager for twenty-four years. Appearing with me is Curt Olson, manager of the Cascade Telephone Company of Cascade, Iowa. Cascade Telephone Company has two exchanges with 1275 main stations. Curt started with Northwestern Bell in 1951. Since 1962, Curt has been managing telephone companies in Lone Rock, Iowa; Goldfield, Iowa; and Green City, Missouri before settling in Cascade.

I am President of the Iowa Telephone Association. I have been a director of the Iowa Telephone Association since 1970 and Curt Olson has been an Iowa Telephone Association director since 1978. The members and directors of the Iowa Telephone Association are extremely pleased to have this opportunity to appear today to discuss legislation restructuring the telecommunications industry, as well as the AT&T antitrust settlement.

Iowa's telephone industry is unique. There are 161 operating companies with at least one or more exchanges in Iowa. All 161 operating companies from the largest (Northwestern Bell) to the smallest (Miller Telephone Company) belong to the Iowa Telephone Association. There are about 1480 Independent telephone companies in the United States. Eleven percent of all Independents are in Iowa. The average size of the Independent company operating in Iowa is much less than any other state. We have six companies with less than 200 main stations and 100 with less than 1000 main stations.

There are only five companies (Central Telephone Company, Continental Telephone Company, General Telephone Company, Northwestern Bell Telephone Company, and United Telephone Company) with over 5000 main stations.

Iowa is also unique in its regulatory law for telephone companies. The Iowa State Commerce Commission was given the authority to regulate rates, charges, and services of telephone companies beginning in 1963. At that time, the Iowa Legislature recognized the cost and effects of regulation on small telephone companies and exempted from "rate regulation" all cooperatives, mutuals having at least 50 percent of their users as owners, and all companies with less than 2000 main stations. In 1981, the Iowa Legislature amended the law to exclude from "rate regulation" all companies with less than 15,000 main stations. Today, the Iowa State Commerce Commission regulates the rates of only five telephone companies. All 161 companies are service regulated and subject to the service rules of the Iowa State Commerce Commission. The move to deregulate small telephone companies by state legislatures is growing. Minnesota has deregulated cooperatives and companies with less than 2500 main stations. We understand that the Minnesota Legislature is giving consideration to raising the exemption to a larger figure. Also, Nebraska and Missouri are considering legislation to deregulate small telephone companies.

This leads to my initial comment on HR5158. Section 226 of HR5158 would require filing of tariffs by all regulated carriers with the F.C.C. for acceptance. In addition, all agreements, contracts, or arrangements between regulated carriers would have to be filed with the F.C.C. (Section 223 (l)) This is, in our opinion, unnecessary and contrary to actions by state legislatures to deregulate telephone companies and results in a great deal of needless costs.

The question of federal/state regulation is a concern. When Section 211, which establishes the jurisdiction of the F.C.C., is coordinated with Section 301(29), which elaborates the definition of "electronic transmissions," problems result. The two Sections read together appear to give the F.C.C. pervasive authority over all communications activities of telephone companies. In fact, regulation is drastically extended. These Sections appear in contrast with Section 231(a) which says:

> "Except as otherwise provided in this title, state commissions shall have exclusive authority to specify the carriers, rates, terms, and conditions for the offering of exchange transmission service."

This language could be meaningless if the F.C.C. is permitted to intrude, based on the definition of "electronic transmissions." We have always felt more comfortable with state regulation than federal. Customers can now own terminal gear. Soon we expect customers to be able to own inside wiring. Many, if not all, state regulatory agencies have rules establishing minimum service standards. Carriers no longer have end-to-end responsibility. How can states enforce their service standards? HR5158 would appear to offer little reason for existance of the Iowa State Commerce Commission or other state Public Utility Commissions. If there is to be regulation, it should be local, from the state, not from the federal government.

Section 272 allows that customers may purchase in place terminal equipment from a telephone company; and that once the terminal equipment is fully depreciated, the customer has full ownership. The Section goes on to allow for public sale of company-owned terminal equipment. This is very confusing in that if the customer is to own the terminal equipment at the end of its depreciated life, how can we provide for a public auction of the same equipment? I think the Iowa Telephone Association is opposed to this Section of the Bill; but because of the confusion as to who owns what and why and questions as to a public sale, I am not sure what our position would be.

Section 273 establishes a transitional joint board which according to Section 234 will administer the National Telecommunications Fund. "The transitional joint board shall be composed of: (1) three commissioners of the Commission, designated by the Commission; and (2) two state commissioners nominated in accordance with Section 410(c) and approved in accordance with Section 410(a)." We would suggest that the group administering the National Telecommunications Fund should have telephone industry representation. In allocating payments from this fund, expertise and experience of working telephone persons would appear invaluable. We question if there is any logical reason as to why the National Telecommunications Fund should not be totally administered by industry representatives. The "Settlement and Separation Procedures" for toll settlement have been very satisfactory and the procedures are entirely a result of industry negotiation with overview by the F.C.C.

Section 234(b)(3) recognized the need for local rates to be established in a manner which will continue universal telephone service at reasonable rates. The Iowa Telephone Association's Board of Directors recognized a need for subsidies to high cost/low density rural areas and passed a Resolution on October 20, 1981, for consideration by the Federal/State Joint Board. (Copy of Resolution attached at Exhibit A.) We are concerned that Section 234(b)(3) applies to carriers rather than exchanges. In providing subsidies, areas should be identified by the size of exchange, not by the total number of telephones served by a carrier in all exchanges. The size of a carrier is not a relevant means of determining if a subsidy is needed to support the needs of a rural area to providing telephone service.

Section 282 of HR5158 provides for funding of intervenors activity. The Iowa Telephone Association has opposed this type of activity in the Iowa Legislature because we feel that it is unfair to use company revenues to oppose the company. There is little or no control over who can intervene nor the issues being raised. Without proper controls or restrictions, an intervenor under this provision could cause an unnecessary extension of a rate proceeding and excessive costs which are ultimately passed on the utility customers. Such groups should be funded by voluntary funds.

The exclusion by Section 264(b)(1) of provision of CATV services by a telephone company does not need to exist by law. There is no justification now for excluding telephone companies from Cable Television, except to protect the existence of a monopoly for CATV operators. CATV, as other communication services, should be subject to competition. This could hasten CATV to areas currently unserved. We can be effective competitors. Should CATV customers suffer from the lact of competition? This prohibition should not be codified. The F.C.C. seems to be cognizant of the market and lack of CATV to many areas. They have seen the error in their long-standing prohibition and are gradually changing their rules to allow greater competition in CATV which is also bringing the availability of this service to many more people.

We have also been asked to comment on the AT&T antitrust settlement and the divestiture of the Bell Operating Companies from AT&T. Within the industry, divestiture is not the concern. The concern is what regulations and laws are passed as a result of, or in connection with, the divestiture. If you can tell us what regulations and laws are going to be initiated, we can relate to you the effects. At this time, there are many questions which appear to remain unanswered until the divestiture takes place, or until legislation is passed by both Houses of Congress.

You can be assured that the Iowa telephone industry is very concerned about universal service at reasonable costs. Iowa is a rural state. We have seen examples in this state of the effects of deregulation of the trucking industry and airlines. Iowa's large communities are comparatively small. Air transporation is leaving such towns as Fort Dodge, Dubuque, Burlington, and Ottumwa. Each one of these towns have sizeable manufacturing entities. With the loss of air transportation, there is speculation on the future of these businesses in these towns. What about Iowa's smaller cities and towns? Universal service is a necessity to Iowa's smaller communities. Access into Bernard, Wyoming, Andrew, Onslow, Center Junction, La Motte, and other small exchanges in Iowa and across the United States is mandatory in our opinion. Long Line carriers must have a clear mandate to maintain and utilize the existing network. They should be prevented from any means of bypassing that network. Protection must be provided so that the "total" network is continued to provide access into and out of rural homes and businesses through local exchange. It could be economically disastrous if the Long Line carriers are allowed to pull out of markets or to provide a direct toll connection to large companies and ignore the local telephone company.

Thank you for this opportunity to speak.

Howard Sorensen, President
IOWA TELEPHONE ASSOCIATION

EXHIBIT A (HR5158)

RESOLUTION OF IOWA TELEPHONE ASSOCIATION SUPPORTING THE ADOPTION OF THE CONCEPTS OF AN ACCESS COST FACTOR (ACF) FOR USE IN JURISDICTIONAL SEPARATIONS PROCEDURES

Whereas, The telecommunications industry is undergoing significant technological and structural changes; and

Whereas, Revisions to the procedures for the allocation on non-traffic sensitive (NTS) exchange plant investment in the jurisdictional separations process may be appropriate due to the ever increasing allocation of exchange access cost under current separations procedures, and

Whereas, Any revisions to the current separations procedures must continue to facilitate the maintenance of universal service at reasonable rates in all areas of the country; and

Whereas, Small telephone companies serving rural areas have unique characteristics of low subscriber density and small exchange size which result in high costs per subscriber; and

Whereas, Many of the proposals submitted in CC Docket No. 80-286 would adversely affect the small telephone companies serving primarily rural areas; and

Whereas, An ACF Proposal should recognize the additional cost factors of low subscriber density and small exchange size; now, therefore, be it

Resolved, That Iowa Telephone Association supports the concepts of an Access Cost Factor (ACF) and urges the Federal/State Joint Board to recommend the adoption of similar concepts in the aforementioned proceeding.

Mr. TAUKE. Thank you, Mr. Sorensen.

Our next witness is Curt Olson, general manager, Cascade Telephone Company.

STATEMENT OF CURT OLSON, GENERAL MANAGER, CASCADE TELEPHONE CO.

Mr. OLSON. My name is Curt Olson, and I am general manager of the Cascade Telephone Company in Cascade, Iowa.

My duties in addition to managing the company include at times bookkeeping, directory sales, telephone repair, office clerk, janitor, snow shoveler, lawn mower and collection agent.

Mr. WIRTH. You ought to run for public office.

Mr. OLSON. The information I have prepared represents only my own thoughts and the data compiled reflects the company that I work for.

I have compiled this data so that I hope the people attending this hearing will understand how a small rural Iowa independent telephone company operates. The following information reflects the operation of the Cascade Telephone Company for the year 1981. We provide telephone service to two exchanges. We serve about 1,300 customers. We provide one-party service to all customers. We have installed over 250 miles of cable to serve these 1,300 customers.

Our telephone plant in service at original cost amounts to $1,934,757. Our investment per customer is about $1,480. We have a customer density of about five customers per mile. This includes the town of Cascade. Our records show that in 1981, 68 percent of our maintenance time was spent repairing our customers' telephones or wiring in or around the home or business.

Our company keeps informed of the latest changes in telephony by belonging to the telephone associations. We pay dues to the Rural Iowa Independent Telephone Association, the Iowa Telephone Association and the U.S. Independent Telephone Association.

Our company receives toll revenue amounts based on average schedules which result from USITA/A.T. & T. negotiations. In 1981, our A settlement amounted to 65 percent of the gross amount of toll billed to our customers. In 1981, our revenues consisted of local service revenue, 44 percent; toll revenue, 55 percent; other revenue, 1 percent.

We have four full-time employees, including myself. I hope from this information you will get a rough sketch of how a small rural telephone company operates. I would also like to convey to this hearing today that I am concerned as a manager because, No. 1, if A.T. & T. and other long distance companies compete for the big toll users by reducing rates, will this cause the small toll users in rural Iowa to pay higher toll rates? After A.T. & T. is broken up, will we still receive 65 percent of the total revenue bill? Will some type of local access charge apply when long distance companies provide only the toll facilities that don't have to provide local service to the rural customer? What happens if none of the long distance companies decide to provide access to their system because we have small exchanges some distance from the main routes? Will the quality of telephone service as we now know it decline because of wear and obsolesence when the customers own their own station equipment and wiring?

I will close by asking is reliable telephone service at a reasonable rate going to disappear from the rural area? I don't know the answer to that question and I believe it will depend on how our Government handles the A.T. & T. breakup and the rewrite of the Communications Act.

Thank you.

Mr. TAUKE. Gentlemen, thank you for some very informative testimony.

Mr. WIRTH. Yes, gentlemen, thank you very much.

Let me ask you first a very brief question. Do you think that legislation is needed and that we ought to move on legislation right away?

Mr. LEIN. Yes, Congressman, I do believe that legislation is needed. I think there might be one, maybe, caution and that is to watch the implementation of the antitrust settlement to see how legislation might affect that. I don't know how you solve that timing problem.

Mr. WIRTH. Does that mean that we ought to pass legislation after the settlement is in place?

Mr. LEIN. Well, not necessarily, but I think maybe proceed with caution while the implementation is taking place.

Mr. WIRTH. We are nothing if we are not cautious.

Mr. SORENSEN. Yes, I believe we should have legislation and our serious concern is that we get some sort of subsidy to protect the small rural exchanges.

Mr. **Wirth**. Which means legislation now.

Mr. **Sorensen**. Right.

Mr. **Wirth**. Mr. Olson.

Mr. **Olson**. I concur with Mr. Sorensen.

Mr. **Wirth**. Let me run through, if I might, Mr. Sorensen, your very helpful set of points just to make sure. The first two relating to section 226 on filing of tariffs and the authority of the FCC discussed earlier, that was in that section, I believe, the ambiguities of that are an area that we have worked out with all the independents. And I think that that problem is now taken care of in the legislation so that that authority does not exist there and as Mr. Lein said, take full steps, we reserve in the legislation the authority of the States not to regulate as Iowa and Minnesota have done, feeling that that's an appropriate role. And if the State wants not to regulate, the State can not regulate and that is the dominant theme running through that area of the legislation.

On the customer equipment issue, the third issue you raised, Mr. Sorensen, you mentioned that used equipment market exists now and that therefore we should not be concerned about creating a secondary market for used equipment.

Is there currently any place in the country a secondary market for Bell equipment, Western Electric equipment?

Mr. **Sorensen**. I would imagine there could be. As far as independent companies, we have firms in the State who repair used equipment and handle used equipment, buy and sell used equipment.

Mr. **Wirth**. Is that Western Electric equipment or Stromberg equipment?

Mr. **Sorensen**. Most of what we use would be Stromberg or ITT or something of that type.

Mr. **Wirth**. Do you know of any place where Western Electric—Bell equipment is the dominant, as we know, number of sets in the country—do you know of any place where there is currently a secondary market? In other words, a used equipment market for Western Electric equipment?

Mr. **Lein**. I would guess that the market might not be substantial. It is probably a small market.

Mr. **Wirth**. I would be interested if you all had any further data on that because I didn't know that there was any used equipment market for Bell equipment. There is for Stromberg and some of the competitive equipment. And one of the issues that we were addressing is how do you get more competition into the equipment market, and one of the ways of doing that is to allow the local operating company to depreciate that existing embedded terminal equipment. And then at the end of that period of time, to create a secondary market so the customers can buy used equipment as well as new equipment. Small businesses can upgrade and so on. So you have more choices for consumers.

If you have anything on that, I would be interested to know if in Iowa you know of a market where used Western Electric equipment, Bell equipment, is sold.

Third, on the TJB, you were talking about having that left with industry representatives. That goes right to a question of very broad public policy. If we are talking about assuring that funds are flowing to rural areas of the country so that rural areas are tied into the communication system just as we do through rural mail service or rural electrification or rural highways and so on, because that is a public policy concern and that those concerns should be defined as a matter of public policy by public officials, just as we do with rural electrification, mail, and so on. So that has historically in the telephone system been done as you point out through separations and settlements privately.

I think everybody has generally agreed that that shift would go to the TJB. Unquestionably, you would have a lot of input into that process. But that is just focusing on that fourth point that you made.

Fifth, on universal service at reasonable rates, I wasn't quite sure I understood your suggestion that we ought to focus on size of exchange rather—could you clarify that?

Mr. Sorensen. Yes, Continental Telephone is an example in which they own an exchange that only has 150 stations, just as I might own an exchange having 150 stations and we felt like the subsidy should apply to the size of exchange rather than size of system.

Mr. Wirth. Size of exchange rather than the size of—I've got it, OK, very good. I am familiar with that issue.

The intervenors question is one that we are going to get to. That will be an issue of discussion, I am sure, when we get to markup and there are some who believe that there should be intervenors and some who believe they shouldn't, and I suspect that will be decided in wisdom by whomever has 50 percent plus one of the votes.

Mr. Tauke. We will a have tie vote here.

Mr. Wirth. Finally, on cable television, in 5158, we leave it to the FCC to determine, you know, where in rural areas there should be an overlap between cable and the telephone company, you know, allowing cable and telephone companies in rural areas to get together. And what level do you become no longer a rural company but become more of a concentration and we do believe that there should be clearly that access of rural consumers to cable services. And that it would be disfunctional and certainly not economic to run a second set of cable wires across the long distances, for example, you were talking about, Mr. Olson.

So I think that is in the legislation and if that language is not adequate or doesn't seem to solve the problem, please let us know about that. I think that that problem is solved. We worked with all of your people on that but if that, given the Iowa situation and so many independents here, if that does not solve the problem, we would certainly like to know about that.

There is one final set of issues. You all have talked about long distance and the threat which both you, Mr. Sorensen, and you, Mr. Olson, spoke about of the potential of the Bell System being able to come in and take all of the big customers off the system, therefore leaving less of an access charge being paid into the local system, particularly sparsely populated, hard-to-serve, expensive-to-serve rural areas, which would then result into a diminution of your service and your rate base. Is that a fair summary of your concern?

Mr. Sorensen. Yes.

Mr. **Wirth**. The question is then should the new parent, A.T. & T., be allowed to offer long-distance services in competition with its own long line, where the new parent has long lines, Bell Labs and Western Electric? Should the deregulated side of the new A.T. & T., Western Electric and Bell Labs, be able to offer duplicate long-distance services or facilities in competition with long lines?

Isn't that just the concern you were talking about?

Mr. **Sorensen**. Our concern is that we presently are served by Bell or A.T. & T., if you will. That we continue to be served, I think, is our main concern, that we just not be dropped from any toll carrier, I think, is our primary concern.

Mr. **Wirth**. Which means that therefore long lines should continue to be regulated; is that right?

Mr. **Sorensen**. Well, to the point that they are required to furnish service to us, yes.

Mr. **Wirth**. But the argument is made by some that because there are some competitive entrants like MCI which had last year eight-tenths of 1 percent of the market, that because there are some competitive entrants, that therefore long distance is competitive and therefore should be deregulated. And that is the argument that is made for deregulating long lines. Which therefore, it seems to me, leads to the airline analogy you were talking about, that you would end up with the product they deregulated, they no longer have the requirement to connect up with your company, right?

Mr. **Sorensen**. Right.

Mr. **Wirth**. So therefore your conclusion would be that long lines should not be deregulated until, in fact, there really is a competitive marketplace and if they are not serving you, somebody else will come in and serve you, right?

Mr. **Sorensen**. Right.

Mr. **Wirth**. That's the conclusion that you would come to, then, right?

Mr. **Sorensen**. Right, that is my conclusion.

Mr. **Wirth**. Mr. Olson, is that consistent with you?

Mr. **Olson**. Well, I think also, that most of the argument has been that long distance can compete; that you can have more than one long-distance company providing total service.

A concern of a small telephone company is that we don't become isolated out in the wilderness and everyone says—a similarity is service from Chicago to New York with the airlines, and we don't become a Dubuque in this instance. That is the only town I know about because they lost their airline service. Are we going to be sitting out in the sticks, out in the rural area, and not have access to a long-distance company? And everyone says, "We don't want to go out there. It is not cost effective to go out there."

Mr. **Wirth**. And the threat is that if long lines was deregulated, long-line services to Cascade might go the way of airline services to Dubuque. That is the parallel.

Mr. **Olson**. Right.

Mr. **Wirth**. So therefore, long distance, in your opinion, should not be deregulated?

Mr. **Olson**. I didn't say that. I just want to make sure somebody is there.

Mr. **Wirth**. I am trying to figure out what you are saying.

Mr. OLSON. I think that deregulation of long-distance service in the high user areas, the big cities, is a lot different than deregulation of service out where the plums are not quite so good. That is why you people are the legislators, to figure out.

Mr. WIRTH. Thank you. Mr. Tauke.

Mr. TAUKE. Thank you, Mr. Wirth. We covered a lot of territory already.

Mr. Lein, you mentioned the joint transition or the Transitional Joint Board, that you felt it should have a longer life than 5 years. We have discussed that a little bit, also. Perhaps you may want to expand on your comments just a bit as to why you think that that Transitional Joint Board should remain in existence for a longer period of time.

Mr. LEIN. Well, I guess, it seems to me that that is going to be a small board with a small staff carrying a very tremendous function in the handling of the access charge, all of the moneys in the pool. I believe that we are going to go through it. The transitional period is going to go fast. I believe that the 5 years is going to come to an end very quickly and see that very complex mechanism that the Transitional Joint Board is handling be then dumped on the lap of the FCC, that worries me. I think it is simply too short.

Mr. TAUKE. Mr. Olson, in your testimony, one thing that you said that I think is rather striking is that 68 percent of the repair that you do, even in a system where you have only five customers per mile, 68 percent of the repair is done in and around the home.

In your system right now, do you have all of your own equipment being used by your customers, equipment that you have sold them?

Mr. OLSON. We have a very, very small amount of foreign telephone sets. In other words, sets that are owned by the individual customer. They are very, very small.

Mr. TAUKE. How do you treat the situation now if you have a customer who calls you who has a piece of equipment that is foreign, I guess, as you call it, how do you handle that if the service problem appears to be in that piece of equipment?

Mr. OLSON. First of all, if they have followed the rules that they are supposed to follow, they would have brought the piece in before they installed it, let us know that this is a piece of foreign equipment. So if foreign equipment is at a customer's premises, we would not fix it, first of all, because we probably wouldn't have repair parts to fix it, anyway. It may or may not be a common piece of equipment with the type that we maintain. It could very easily be made by a different competitor that we don't carry parts for. We would want no responsibility for maintaining something that we don't have the parts to fix.

Mr. TAUKE. Do you foresee this becoming a bigger problem down the road, this whole problem of who is going to repair what portion of the telephone system, especially in the rural areas? Do you have any thoughts as to how we can prevent what seems to be rather foreseeable problems?

Mr. OLSON. Well, the owning of customer equipment is not a new thing. This happened a long time ago. They call them service lines where the individual farmers own their own poles, their own wire and their own telephone, and so on.

The telephone company provided so much better service, that these went by the way very quickly and I kind of have the feeling that we are going back that way again. Is a customer going to fix that cord, is he going to fix the dial, is he going to fix the inside wiring? Maybe it still works, but it doesn't work too good. But he says, "Well, if I have to pay for it, maybe I will let it go for another 2 months." If we maintain the equipment, the customer doesn't have that outlook. He calls us and he expects us to come right out and fix the equipment, which we do.

But I see a problem, especially in service, because telephone service is unique, compared to electric service, gas service, and water service, in that it affects two people and a whole system. It affects not only the end that if there is trouble on a telephone, it not only affects that end, it also affects the person he is talking to.

So if the person at the other end goes to the telephone company or reports they have telephone trouble, how do you run down where the trouble was? It is just going to be a continual problem of upraising the amount of trouble that is on the telephone system and not being able to chase it down.

A similar thing, I think, will arise when we get more than one long-distance company. Today, when trouble arises, we contact the long-distance company and the long-distance company says, "All right, let's check it." Can you imagine what's going to happen if we have—somebody said there is going to be 200 different long-distance companies. If you have a whole quandary of long-distance companies involved, how are we going to check the phones? How are you going to ever know where the trouble is?

These are concerns that a small telephone company manager has because he knows everybody walking down the street and if their phone don't work, they will let you know very quickly.

Mr. TAUKE. Do any of you in your systems have major customers who have put a dish up on the roof of their office building or their plant or factory and bypass the local system for long-distance service, thus avoiding the local exchange rates? Have you had anybody who has done that in your system now and do you foresee it happening in the future?

Mr. SORENSEN. We don't happen to have, Tom. We serve 5,000 customers in over 1,400 miles of cable. We have a density of 3.7 per mile. My big customer is a businessman with a key system, with three lines and six telephones. That is a big business customer. He isn't liable to be the one that will put up a dish. He is also not the one that will benefit from any kind of competition. He is going to be a loser in that one.

But OPASTCO, of course, does have in its 400 members have a substantial number of business customers who have been lost through a satellite dish, through microwave systems and through private communications. And in some cases, the results have been disaster when it comes to lost revenue. And we really feel that this is going to continue that other entrepreneurs, A.T. & T. is going to be stepping into our areas and picking off our lucrative customers and it is really going to hurt our average of the local service pool and those rates. It is going to be devastating to us.

Mr. TAUKE. As a general rule in Iowa, do we have situations where another company could come in and do some cherry picking and pull off a few customers from the small companies or are our companies in Iowa, our small companies, primarily servicing solely residential and very small business customers?

Mr. **Sorensen**. Primarily I'd say they are servicing residential and very small business customers.

Mr. **Tauke**. So you don't foresee this as a big problem for Iowa?

Mr. **Sorensen**. I am sure there will be some in the larger companies.

Mr. **Lein**. Well, like Eldridge. What plant is at Eldridge?

Mr. **Olson**. Caterpillar.

Mr. **Lein**. Caterpillar plant at Eldridge, it would be devastating if they lost that customer.

Mr. **Tauke**. One other question relating to the long lines, all of you indicated that you believed that there should be some requirement that long-line services be extended to your exchange areas. But I didn't hear anyone suggest that there should be a regulation on the price or charge that is being made for that service. Do any of you have feelings about that?

Mr. **Lein**. Well, I think that the advent of competition in the long lines should tend to maybe drive prices down and generally there would be some benefits to be had from that. But I believe that in the low-density areas, that there will be no competition in toll and those routes, I think, could tend to be high. And as I understand it, doesn't H.R. 5158 have the mechanism in there to protect the local exchange from high losses and averages on toll, as well as the 110 percent support for the local service area?

Mr. **Tauke**. Right.

Mr. **Lein**. I think that is a critically important point, Congressman Tauke, that will be a safety net and a safeguard for the rural people.

Mr. **Tauke**. Any other comments that any of you have?

Mr. **Wirth**. Again going back to the question of legislation, which I started out with earlier questions, as to when, if we should pass legislation and when. If, as I believe, that particular pool is terribly important to assure rural telephone service, just in the discussion that you had with Congressman Tauke, shouldn't that be very clear and in the law as part of the organization of the settlement, so that everybody understands what the rules are going to be in terms of that access charge pool? Shouldn't that be done right away, rather than having, say, the settlement go through and then you may have an abrupt jump up of rates or that subsidy pool is not available. It seems to me that in terms of the kind of certainty that I think all of us want to see, to have all of the settlement over and the court suits over and the legislation over it, to do it all at one time, merging them all together, what you are pointing out is a very important element. It should be done right away.

Mr. **Lein**. I can't argue with that. I think that you are right, that it should be done right away.

Mr. **Wirth**. Just on the schedule, it also works, you know, by the time this Congress is over, that 6-month period, presumably the time of the court making its final determination and in the planning session for Bell in that 6-month period of time, merges very neatly with the timeframe of the legislation and we can have everything in place and that kind of certainty by the first of the year, 1983.

Mr. **Lein**. Well, I believe, too, we as independents feel, Congressman, that I think we honestly feel in our hearts that we, as small independents, could benefit from legislation that might occur in the next 6 or 12 months as opposed to a point of time when the divesture is implemented and then we have lobbying efforts on behalf of A.T. & T. lobbyists, as opposed to the Bell lobbyists. I think we may be heard better by you, Congressman, in the next 6 months than we will in the next 2 years.

Mr. **Wirth**. We don't have 12 months because the Congress ends and then you have got to start all over again. There is a terminal nature to each Congress and then everything starts de novo.

As you would paraphrase that famous coach of the Washington Redskins, George Allen, who once said, "The future is now." You got to do it now.

Mr. **Lein**. I agree with that.

Mr. **Tauke**. None of you, as I recall, mentioned anything about the definition of exchange areas. It occurs to me that that is something that could be quite critical for you. Do you have any observations on that question?

Mr. **Sorensen**. Basically we have exchange area boundaries now that are filed with the State of Iowa. And basically we all try and pretty much stay within those boundaries.

Mr. **Tauke**. It is my understanding, though, that those boundaries could be altered by the consent decree. Is that an accurate understanding? Or do you have a different perception?

Mr. **Lein**. I assume you are correct. And, of course, this is another area where I think we could benefit from legislation. It would put the decision on the size of boundaries in the hands of the State commissions like Andrew Varley's commission here in Iowa. The important thing about that is that we are close to Andy Varley. We can speak to him. We can talk to him. He is not distant like FCC is. How many of our small companies travel to Washington to meet the FCC or deal with the FCC?

Mr. **Wirth**. We have trouble meeting with the FCC.

Mr. **Lein**. They are so remote to us that we need to handle this, I think, at a local level because they are so inaccessible. And I think that the exchange boundaries, if we can have some input into it, at this moment, it is difficult to see, when we talk about the possibility of no longer having intrastate calling but having intraexchange calling and interstate calling and, frankly, for laymen like some of us here, that's difficult at this point to comprehend. But it is a critical issue.

Mr. **Tauke**. Well, gentlemen, your testimony has been most helpful to us and I want to thank you for coming this morning.

Mr. **Lein**. Thank you.

Mr. **Sorensen**. Thank you.

Mr. **Olson**. Thank you.

Mr. **Tauke**. Our next witness is Al Beach, who is the general sales manager of the Direct Dialing Division of Teleconnect, Inc.

Mr. Beach, we want to welcome you to our hearing this morning. You may proceed.

STATEMENT OF AL BEACH, SALES MANAGER, DISTANCE DIALING DIVISION, TELECONNECT, INC.

Mr. BEACH. Thank you, Congressman Tauke, and thank you, Chairman Wirth, for inviting me here. This is a good opportunity to present the views of Teleconnect regarding resale in the marketplace. And I would like to make an observation that I appreciate very much being, although I don't like the attention, I like the fact that we have been split out in some way so that we are a unique group.

The reason is that we are much users as we are providers here. We really are on that threshold between the provision of service to a customer and the user of interexchange facilities. We do not, for the near term, expect to be in the business of providing interexchange facilities. We do expect to be extremely large users of what will probably be predominantly Bell services, although the option to use regulated carriers is certainly there available to us because there is a mix.

So you could say we are the only hybrids represented here today.

Teleconnect is an Iowa corporation headquartered in Cedar Rapids. It was founded just 2 years ago but last year sales of customer terminal equipment exceeded $2 million. That is a fairly good success rate and enough so that it has allowed us to branch out into long-distance resale, beginning this summer.

Why resale? Now that long-distance calling is no longer a matter of just paying the phone company as it has been in the past, the user can easily become confused about rates and routing. Today the questions are which phone company, how much to pay, which service and where are the tradeoffs?

Our users must have control of their long-distance traffic and options in order to keep their budgets in line. However, the typical user can't afford to engage in constant network redesign and run their own organization or residence or rural telephone company, too.

That is where the resale of common carrier services comes in. A network manager can provide the control for a very small fee. And a locally based company like ours can be more responsive than a national carrier. So since we know we will be satisfying a user need, we have a vested interest in protecting the right of resale during this time of change.

In the time that I have remaining, I want to discuss the modification of the consent decree or the divestiture agreement and H.R. 5158, the user's bill.

First, the divestiture agreement. It is a unique agreement in that it says—takes several pages—but says so little, and one of the things it does not say is anything about resellers. There is absolutely no mention of the organization and, as a matter of fact, there are great pains in there to make definitions that do not include resalers so there are no prohibitions nor are there any enabling language in the divestiture agreement.

On the other hand, he gives A.T. & T. unilateral rights to provide interexchange service, even intrastate which is a right A.T. & T. and resellers don't have today.

In the agreement, equal access is guaranteed for carriers with interexchange facilities. But does equal access extend to resalers and at a price that is reasonable? And how does that compare to the user's bill? And I have the December 10 version of it and that is the one that I would be talking about.

The user's bill clearly defines resalers and their rights. In addition, the National Telecommunications Fund appears to be an acceptable vehicle for fairly allocating access charges back to the exchanges, whether rural or metropolitan. But we do urge that more definitions of reseller's status be included in a new rewrite, definitions that would insure that, one, user access to resellers be as convenient as user access to common carriers; two, common carriers would be required to offer nondiscriminatory interconnection to resellers as they would to a large user; and, three, resellers be exempted from paying an access charge if the underlying carrier is also charged access for the same call.

In other words, we surely don't want to see any kind of double taxation.

Currently the rights of resellers are being formulated in a somewhat hit or miss fashion at many regulatory levels. The Iowa State Commerce Commission does not allow resale of anything other than MTS, Message Telecommunication Service, which is the most costly service in the marketplace.

The FCC, on the other hand, allows resale of MTS and WATS on an interstate basis, but use of private line facilities by resellers is an issue very much up in the air right now.

Let me assure you that acronyms like ENFIA are giving us many more gray hairs than we ever wanted to have. We believe that the resale function is probably the most exciting new concept that will arise in the next few years and it lends itself very well to a local competitive marketplace and it is more local in scope than national. And we do believe that Teleconnect needs legislation now to safeguard a competitive service that is highly use oriented and therefore very valuable in the marketplace.

Thank you.

[Mr. Beach's prepared statement follows:]

Teleconnect
INTEGRATED BUSINESS COMMUNICATIONS

February 11, 1982

1. Who is Teleconnect?

.01 Teleconnect Company was founded as an Iowa corporation in December of 1979. Many of its 35 employees have been in the telecommunications industry since 1968. They have joined Teleconnect from such companies as Bell Telephone, Rockwell International, Sperry Univac and United Telephone.

.02 The company has expanded at a rapid rate. We currently serve over 250 business, governmental and educational accounts who bought or leased equipment. Our revenues in the second full year of operation were in excess of two million dollars ($2,000,000.00). Projected 1982 systems sales should top three million ($3,000,000.00).

.03 Teleconnect has been unique in its marketing approach by including counseling with equipment proposals. The results of our counseling on long distance usage convinced us that the Eastern Iowa user needed more alternatives than are available today.

.04 In 1980, Teleconnect began planning a network management service utilizing a computerized switch to select call routes for our users. This service will be available in the second quarter of this year. The users will benefit from lower costs-per-call and greater employee accountability. Today, my remarks will cover only Teleconnect's network management service.

.05 We know that the user will benefit from our service, Bell will benefit from our high volume of calls and that we can be profitable if allowed to operate in a truly competitive marketplace. As you will see today, your pending legislation will do more to help our cause than the Divestiture Agreement, state commissions, or "natural" evolution of policy.

2. Key Components of the Divestiture Agreement

.01 Little is known about the future of this agreement at this time, but three issues are most important to us:

(a) The transfer of assets for exchange telecommunications from AT&T to the BOC's.

(b) Separation of exchange telecommunications from interexchange switching/transmission and provision of customers premise equipment.

(c) The requirement that BOC's provide all interexchange carriers and information services providers with equal type, quality, and price of access codes, beginning September 1, 1984.

.02 After careful study of the definitions in the Agreement, we still do not know how network managers engaged in resale are viewed.

.03 "'Carrier' means any person deemed a carrier under the Communications Act of 1934 or amendments thereto, or with respect to intrastate telecommunications, under the laws of any state." (IV,D.)

.04 "'Information Service' does not include any use of any... capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service." (IV, J.)

.05 "'Telecommunications Service' means the offering for hire of transmission facilities or of telecommunications by means of such facilities. (IV, P.) This does not include customer premises equipment." (IV, Q.)

.06 "'Customer premises equipment'. . . does not include equipment used to multiplex, maintain, or terminate (exchange) access lines." (IV, E.)

.07 As you can see, Teleconnect does not fit any category recognized by the Divestiture Agreement because we are neither interexchange carriers nor information services providers, as defined.

3. Teleconnect's Concern

.01 The Divestiture Agreement could drive network managers who don't own interexchange transmission facilities out of the competitive arena by simply denying our existence.

.02 Without a clearly defined status, we would be subject to the will of the major parties to the agreement. We could be considered (a) carriers without facilities, (b) users, or (c) not eligible for service.

.03 Nowhere in the agreement does it say that AT&T must provide interexchange service to a resale/sharing firm.

4. Need for HR5158

.01 The "Users Bill" addresses many issues not covered by the Divestiture Agreement. Since Teleconnect is also active in selling customer premise equipment, we continue to support legislation covering:

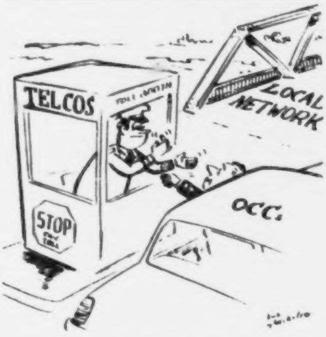
a) User protection during transition
b) Inside wiring
c) Utility funding of regulation
d) Specific safeguards against subsidization

.02 Today, we want to stress our continued support for the following proposals in the User's Bill that relate directly to resale:

a) Formation of the National Telecommunications Fund.
b) Reclassification of carriers into "dominant", "regulated", and deregulated.
c) Public notice for new Tariff filings by dominant and regulated carriers.
d) FCC authority to set benchmark performance and quality of service standards for dominent and regulated carriers.
e) Establishment of absolute rights for resale/sharing users, including specific references to resale whenever appropriate.

.03 Without a law, we believe the future of telecommunications will be left to the dominant and regulated carriers' discretion. User influence will be inconsequential.

5. An Illustrative Analogy



How much to charge?

.01 The above cartoon appeared in the January 15, 1982, issue of Telephone Engineer & Management.

.02 It depicts the local telephone company (NWB) as a toll booth operator, the local exchange (Cedar Rapids) as the bridge, and the Other Common Carriers (MCI, SPCC, etc.) as motorists wishing to cross. The magazine went to press too early to discover that AT&T, through the Divestiture Agreement, has agreed to be one of the "motorists" (carriers) paying local exchange "tolls".

.03 I want to carry this analogy several more steps to demonstrate where Teleconnect should fit into this new environment.

6. Historical Perspective

.01 Until the mid-1970's, Bell's monopoly status required that individual users paid Bell directly for use of the "highway", the "car", the "bridge", and even the final "parking spot"!

.02 Over time, users were allowed more route and vehicle choices from Other Common Carriers. All along, there has been virtually unanimous agreement that building more than one "bridge" (local exchange network) would not be in the user's best interest. As a result, the "bridge" will continue to be a monopoly service.

.03 The Divestiture Agreement is expected to encourage multiple carriers to construct transmission "highways" which will converge at the local exchange "toll booth". Users leaving the "bridge" will directly or indirectly pay a charge per call before selecting one of the highways.

7. Positioning Teleconnect's Service.

.01 Are the user's telecommunications choices confusing to them today? Is there rapid change occurring? Are there lower per-call rates available to high volume users? Do business people need specialty reports not available from carriers or customer premise equipment? Teleconnect believes the answer is yes to all of the above.

.02 The individual business or residential user needs, and will continue to need, a professional network management service. As a network manager, Teleconnect should be positioned just beyond the "toll bridge" at the confluence of carrier "highways".

.03 For greater user accessibility, we should be assigned a dial access code equal in length to those of interexchange carriers.

.04 It will not be in the user's best interest to artificially move us back onto the middle of the "bridge". In other words, if we are forced by unclear regulations to be dial accessed by a local seven-digit exchange number and then tied to the carriers by local exchange lines, then the user suffers two ways:

a) Use of the local exchange facilities is in effect, doubled.
b) The user dials up to three times more digits to reach us.

8. User Benefits

.01 If a network manager like Teleconnect is given dial accessibility equal in quality and length to that provided carriers, and if carriers are required to offer non-discriminatory interconnection to resellers, then the user wins.

.02 To return to our analogy, we will provide the user an added value alternative. We can help the individual user choose from the many "highways" and "vehicles" in the marketplace. By joining many individuals together, we can offer discounts off standard direct dial (MTS) rates. As a local company, we can work closely with individual users to design meaningful feedback reports after the "trip" is made. These reports will be more complete and cost-effective than any the user could generate on his/her own.

.03 We believe a locally-owned, independent network manager such as Teleconnect can continue to maintain a competitive advantage if we are satisfying a user need no one else can fill as efficiently.

9. Need for Additional Legislation

.01 To repeat, Teleconnect's function will be to add value to a user's interexchange call. We will not be in the business of building new transmission "highways".

.02 The User's Bill will surely be rewritten to accommodate elements of the Divestiture Agreement. At that time, we would encourage this Subcommittee to retain much of the original language of the bill, especially the recognition and definition of a "Reseller/Sharer".

.03 In addition, Teleconnect asks for provisions to:

a) allow network managers user accessibility equal to dominant and regulated carriers.
b) require carriers to interconnect with network managers/resellers on a non-discriminatory basis.
c) exempt network managers/resellers from access charges if the underlying carriers' rates charged to us include a cost for exchange access and
d) require that we be given the same time frames for implementation as the carriers.

10. Urgency to Act Now

.01 Without the clout of Congressional legislation, telecommunications policy is currently being formulated in a patchwork quilt-like manner. We believe resellers/sharers and, indirectly, our users are suffering the most damage.

.02 The Justice Department, the courts, Congress and the FCC are working indpendently toward results. The Iowa State Commerce Commission allows only resale of MTS on intrastate service and is not actively working on any other resale provisions.

.03 The FCC had 13 important proceedings in progress at the end of 1981, all related to the issues your Subcommittee is addressing. Two have profound effects on Teleconnect.

.04 Docket CC 79-54 allows resale/sharing of interstate WATS. Docket CC 78-72 will eventually categorize exchange access charges by type of service.

.05 Until exchange access charges are resolved, resellers are being certified by the FCC as Resale Common Carriers. When local exchange facilities are used to terminate a user's call on equipment at the reseller's premises, the reseller is charged ENFIA fees for the line. ENFIA means "Exchange Network Facilities for Interstate Access".

.06 The call is then processed by the reseller and sent out on ~~Other~~ Common Carrier facilities.

.07 Currently, the ENFIA line fee is $122.00 a month. It serves the same purpose as a line costing Bell's Cedar Rapids business customers from $28.00 to $35.00 a month. OCC's with intercity transmission facilities pay this ENFIA fee to reimburse local exchanges for revenues they would have shared with AT&T.

.08 There are two reasons for the need for immediate relief from ENFIA charges:

(a) We will be using Bell's interexchange network almost exclusively and at the same tariff rates as any large Bell customer. Therefore, no revenue will be lost by the local exchange. ENFIA charges become double taxation when using Bell facilities.

(b) ENFIA tariffs are filed by Bell using Bell's own cost data. One pending at this time could raise each ENFIA line cost from $122.00 to $322.00 a month if allowed. As a reseller, we will need about 500 ENFIA lines. That would mean a monthly increase of $100,000.00!

.09 We hope your Subcommittee will act to end this de facto discrimination against resellers. Our primary function is simply to help users manage their telecommunications costs, for which we will collect a fee. We need legislation passed as soon as possible to protect our competitive position from the fallout of the battle of the giants.

.10 Thank you for your attention to this matter of utmost importance to Teleconnect and our users.

Al Beach
General Sales Manager
Distance Dialing Division
Teleconnect, Inc.
2037 North Towne Lane N.E.
Cedar Rapids, Iowa 52402
(319) 395-0990

Mr. Tauke. Thank you, Mr. Beach.

Mr. Tauke. Congressman Wirth.

Mr. Wirth. Thank you very much, Mr. Beach. We are very familiar with resellers and hope that, you know, we have met the promise of this new marketplace in H.R. 5158, and I appreciate your further suggestions.

Let me ask you one question of broad policy that we began to get in with the previous panel, and that is the capacity under the consent decree of the Bell system to offer duplicate long-distance services and facilities; duplicate to long lines.

Do you think that the Bell system should be allowed to do that or alternatively, should that wait until long distance services become truly competitive where people have choices where they can go in terms of reach and volume, and not offer those kinds of duplicate facilities and services until we have a truly competitive long distance marketplace?

Mr. Beach. Well, if I understand you right Mr. Chairman, you are saying that one alternative might be to have Western Electric and Bell labs design a new type of network, as an example, that might compete with, certainly not with itself, so apparently with the regulated portion. So you would have regulated plus an A.T. & T. sponsored deregulated service that might conceivably compete with it.

Now, there probably is only one concern that everyone would have in that situation, and it was alluded to right here by the last group and that is that regulated service is regulated in such a way that it does insure that it be offered as universally as possible to the Cascade, Iowas, to the resalers, to all the exchanges in which long distance service is necessary.

On the other hand, a company that offers a deregulated service competing against itself probably would have just a terrible time at the executive level, wherever the deregulated group and the regulated group had to fight it out for the next level of management because they are at total odds with each other.

If that were allowed to be done within A.T. & T., I can't envision having one company compete against itself internally in that fashion. Now, maybe it can be done if that competitive service is an enhanced service in some way.

But I would say on the surface, just from a simplistic viewpoint, I can't imagine A.T. & T. offering a deregulated service that competed directly with MTS, regulated WATS, et cetera.

Mr. WIRTH. Well, I can imagine it very easily. If you had the potential of making 25 percent or greater return on your deregulated services and under regulation you are getting 14½ or 15 percent, it seems to me that the decision would be a very easy to make at that point.

Mr. BEACH. So if we were talking about common carriers, then we would be talking about transmission facilities separate from the regulated transmission facilities and therefore more of a specialized carrier situation which would be fine but I suppose one concern that we have, again, as extremely large users, would be who is going to walk that line between the regulated and the unregulated to insure that there is no crossover there at any point.

Mr. WIRTH. OK, so we have the question, it seems to me, one issue is the issue raised by the previous panel of continuing access.

Mr. BEACH. Yes.

Mr. WIRTH. The second issue is one of a cross-subsidy issue which you are talking about and I think there is a third issue that was talked about earlier, one of the previous witnesses, was the question of traffic, high-volume traffic moving off of the existing system. Therefore you lose all of the potential access charges and contributions made by that high-volume traffic on the existing system. You could put a microwave tower up from the Chase Manhattan Bank, run their traffic and service Chase facilities and other banks in the country and suddenly you are in a situation where all the high-volume financial traffic has moved off the system which leaves you then with potential, hypothetically, of the small businesses and individual consumers servicing the national network and you have fewer ratepayers, less volume of traffic going there and then potentially a degredation of service. That seems to me is a progression and one of the things that we have to do is play what if, you know. What if; then what. We have to continue to go down each one of those limbs of the decision tree and see what is there.

Your reaction to that?

Mr. BEACH. Yes, it is just a reaction. It is trying to look into the future and do our what if's, and, first of all, I think someone mentioned earlier that there is going to be a review at various times. So let's say that we are looking into a 5- or 7- or 8-year future right now and not 20-year future. If we are looking at that, then there has seemed to us to be a point where all traffic that leaves an exchange on exchange facilities can be measured. And that is the point that it leaves the local exchange and can be measured by, if you will, traffic studies by the local exchange owner, a BOC that has that local exchange.

If they can measure the traffic leaving that exchange, then they have a pretty good idea of the volume and we are hoping that the solution will not only be equitable, but it would be based on a per-unit basis as opposed to whatever the separation agreements are right now between A.T. & T. and the local telephone companies. We certainly don't know what those are but we would like to see an exchange access charge be a level charge, a fair charge to everyone, and be on a permessage basis and be measured in such a way that then there is a contribution made to the NTF, as an example, who would reallocate it back out on something less than an equal basis per message unit. So that if the Cascade Telephone Co. only had 5 messages and Monticello, nearby, had 50 messages, that there not be 10 times as much value go to Monticello, if that makes any sense.

In other words, the NTF can do its weighting and it seems like it is an acceptable method or surely could be made into an acceptable method of doing that weighting. But we as users or resellers or, I presume, the carriers are hoping is that it is not going to be a negotiated exchange access charge, where they sit down across the table and may the richest one win. It almost has to come down to how much volume are you carrying on those lines. And if you are not carrying very much, are you efficient enough to stay in business, and that is an internal business decision such as the resaler will have to make.

Mr. TAUKE. Thank you very much, Mr. Wirth.

Just one question, Mr. Beach. You indicated you wanted equal access, if you will. How do you define that?

Mr. BEACH. Well, I can define it two ways. One is on price and the other one is quality. We alluded to it just a second ago that equal access can, in terms of price, can be that everybody that wants to pay $100,000 for the first message and $5,000 each for the next two messages and then a nickel apiece for all subsequent messages, that is equal as long as you offer it to everyone. But we may not want a piece of that pie because we are not of that size range, of course.

So equal and fair and reasonable may be two different things. So that is one thing that we hope the legislation addresses is what is equal and reasonable and fair for those people that are going to pay exchange access charges.

Second is quality, and that is if the various carriers in, let's say, a large metropolitan area or even an Iowa large metropolitan area such as Cedar Rapids, has two to three to four carrier choices here, all of them dial accessible by one- or two-digit code, as an example, and then a reseller who wants to make that selection of carriers for a customer, why subject the reseller to, let's say, a seven-digit code when the rest of the world just went two or one. So length of access we would like to see equal for a reseller, equal to the length of access of interexchange carriers.

Second, is the quality. If we are going to be using exchange-line facilities while the carriers are using some kind of central office-to-carrier trunking, then we may not have the same quality levels available to us as resellers as the interexchange carriers have.

Mr. **Tauke**. The provisions in H.R. 5158, do they meet your expectations and what you believe is necessary in this area?

Mr. **Beach**. Short of that.

Mr. **Tauke**. Whereas, the difference between what you would like and what H.R. 5158 provides.

Mr. **Beach**. Well, if we start with the assumption that some of the divestiture agreement will wind up in the legislation, then one of them is this new equal exchange access on a specific schedule and it is moving toward a reduced code, reduced dialable code, if you will. Resellers, I don't believe, had that recognition in that they were given pretty much an unregulated environment. However, the exchange access portion of it would be however we were able to put it together which surely could be back within the exchange somewhere, which would not be as convenient to the user as dialing a reduced number of codes to the various areas.

Mr. **Tauke**. This is complex, but I am sure we will have more conversations as time goes by.

Thank you very much, Mr. Beach. We appreciate your testimony.

Our final panel consists of William Cleveland, vice president, Iowa Telephone User Group, and Chuck Mills, chairman, Regulatory Committee, ITUG.

Gentlemen, I don't know which of you wishes to go first representing the User Group, but if there is no preference, why don't we call on you first, Mr. Cleveland.

STATEMENTS OF WILLIAM CLEVELAND, VICE PRESIDENT AND BOARD MEMBER, IOWA TELECOMMUNICATIONS USER GROUP; AND CHARLES MILLS, ADMINISTRATIVE SERVICES MANAGER, CYCARE SYSTEMS, INC.

Mr. **Cleveland**. Thank you.

My name is William Cleveland. I am administrative vice president of Farmers Grain & Livestock Corp., in west Des Moines, Iowa. I am past chairman of the regulatory committee and a member of the board of directors and current vice president of the Iowa Telecommunications User Group.

The statement I will make summarizes the opinions and concerns of the board of directors, officers and membership of the Iowa Telecommunications User Group.

The Iowa Telecommunications User Group was founded in November 1980, by a group of Iowa businessmen to provide a means whereby users of telecommunications facilities and services and exchange information, experiences and concepts for the mutual benefit of the individual members and their companies, and to encourage technical research and development in the field of telecommunications by means of seminars, conferences, newsletters and special reports. The Iowa Telecommunications User Group has a membership that at the present time represents gross sales of $8.6 billion annually, spends $29 million annually on telecommunications and employs 76,000 people in the State of Iowa.

The Iowa Telecommunications Group has reviewed Congressional bill H.R. 5158 in its entirety and wish to report the following as its findings:

We find it to be proratepayer and as such a welcome change in stance from Congress. Also, in stark contrast to Senate bill S. 898. In fact, an entire part of the bill is exclusively devoted to the rights of ratepayers and throughout the legislation it is explicitly stated that the interest is to maintain and improve the universal availability of telecommunications services at reasonable and affordable rates.

Also noteworthy are the sections which provide for financial assistance to assure ratepayer participation in FCC or transitional board proceedings. And an additional section which directs that tariffs filed with the FCC would no longer become effective on filing as is the case today, but only upon approval by the commission. We find the legislation to be procompetition. The legislation recognizes that A.T. & T. has a unique dominance of telecommunications service and equipment which necessitates safeguards and separation of its regulated and unregulated activities. It recognizes competition varies in existence as well as magnitude on a geographic as well as service basis.

The procompetition provisions in this legislation are essential to assure that users will benefit from advances in telecommunications products and services.

To assure implementation of these principles, the legislation specifically prohibits cross-subsidization, structural separations between monopoly and competitive offerings of A.T. & T., as well as an affirmative obligation on the FCC to encourage competition to the maximum extent possible.

While we have expressed general approval of H.R. 5158, that is not to say we do not have concerns that are not addressed or are ambiguous in the legislation.

Primary among our concern is the fact that A.T. & T. is coming out of this keeping Bell Labs and Western Electric, along with the long-distance network, and shedding the local-operating companies. While A.T. & T. does lose approximately $80 billion in assets, it also sheds itself of the highest tariffed and least profitable of its operations.

We therefore have reservations as the Northwestern Bell being able and, in fact, inclined to maintain the current rate of service, let alone take advantage of new technologies and upgrade service while maintaining the cost within reasonable limits.

While the bill puts authority for regulation of this activity on the State commission, the Iowa Commerce Commission does not provide the same protection to ratepayers, such as not allowing rate increases to be put into effect unless approved by the commission following hearings and providing funding on the State level for ratepayer intervention. We feel there is a need for overview of the operating companies to assure they are living up to their obligations under this bill.

It is not enough to receive promises from Bell Telephone. It must be part of the legislation before the ratepayer is assured adequate protection.

As we pointed out earlier in our statement, the difference between H.R. 5158 and Senate Bill S. 898 is considerable. We wish to express our greatest concern that when H.R. 5158 is passed and sent to the committee to be reconciled with S. 898, the gains made for ratepayer protection will not be negotiated away in order to pass the legislation.

The consequence of such action would be most serious. We implore you to use all the power that you command to see the bill remains intact. If it does, there should be no need for quite some time to enact additional legislation or make interruptive changes in the current bill.

In conclusion, I wish to thank you for allowing the Iowa Telecommunications User Group to participate in these hearings, and we hope our observations will prove helpful.

Should you have additional questions now or at a later date or require clarification, please feel free to call on me.

Thank you.

Mr. TAUKE. Thank you very much, Mr. Cleveland.

STATEMENT OF CHARLES MILLS

Mr. MILLS. My name is Charles Mills. I am administrative services manager for CyCare Systems, Inc., headquartered in Dubuque, Iowa.

As Bill indicated, I also serve on the board of directors of the Iowa Telecommunications User Group, and I am the new chairman of the regulatory committee.

May I make one clarification here, please: Like Mr. Olson from Cascade, I wear many hats at CyCare. One of them is the responsibility for the telephone system that we have. I also am responsible for the purchasing, personnel, and administrative services function. I am not an expert. And that is one of the reasons that I joined the Iowa Telecommunications User Group so that I might learn more about the opportunities to try to sort out some of the confusion, to try to get some direction, and to give my corporation direction as far as the telecommunications industry.

I am certainly a layman and my comments are addressed in that fashion, please.

The statement I will make does summarize some of the opinions and the concerns of CyCare regarding the telecommunications industry and H.R. 5158.

CyCare is vitally interested in the telecommunications industry since our services depend, in part, upon telecommunications with our clients. CyCare has become one of North America's largest providers of data processing services and systems for medical groups since incorporation in 1969. The success of CyCare's data processing services and the end users' use of these products is directly affected by the telecommunications industry.

CyCare serves over 300 physician groups in 35 States and two Provinces in Canada.

The pro-user and pro-competitive objectives of H.R. 5158 is certainly a welcome step to correcting the enormous deficiencies of a giant telecommunications industry. We find the House version more acceptable than Senate bill S. 898, especially in the area of ratepayer rights.

H.R. 5158 generally provides reasonable rules for FCC ratepayer issues. We would like to see the bill strengthened in a couple of areas. First of all, I would like to see that the language of the policy changes or rate increases be in layman's language so that we might be able to make a better response.

Second, we would like to see the process allowing for comments, whether it be on a State level or at the national level, be simplified. Following the rules and regulations is sometimes very difficult and frustrating. We would certainly encourage that prompt decisions be made by the FCC.

We also believe that stability and policy and predictability of rates is necessary to the user. It is also necessary to the user to be given a reasonable amount of time to react to policy or rate changes. An example of that is the recent WAT restructuring that we have just completed. The end user had little time to evaluate the change or to make adjustments or cost-effective plans to cope with these changes. It was here; we had to live with it.

We are pleased that H.R. 5158 recognizes the unique structure of the telecommunications industry in establishing a positive stance to encourage competition. The right of access and interconnection to local and long-distance services at a reasonable rate is essential. We believe that H.R. 5158 needs to expand these rights, especially in view of the recent Justice Department decision.

We believe that H.R. 5158 has taken a wise position that requires charges for services and equipment to be cost-based. The user should not have to pay for services or equipment that they don't need or that they don't want.

Subsidies should be separate from cost-based pricing. And only permitted as necessary in rural or specialized areas.

Since H.R. 5158 was prepared prior to the Justice Department's announcement regarding the breakup, we do have some immediate concerns and questions:

Will the new phone system continue to be able to offer quality maintenance and service at reasonable prices?

Will there be access to technology within Bell labs by outside users who paid for that research through the rate process?

Of course, everybody's question is how will A.T. & T. be regulated so that competition can survive?

The past several years, CyCare has experienced declining service and dramatically increased costs to use the telephone system. While most corporations and individuals can identify with this statement, our problem is somewhat unique because our business has grown at a very rapid pace, especially in the high technology area. Our corporate needs for advanced communications assistance have not been satisfied by the major vendor in our geographic area.

H.R. 5158 provides a key element in providing end-user protection and insuring improvements in the telecommunications field.

In our opinion, if our Nation is to survive its economic blight, it will have to improve productivity in technological areas. Communications is essential to improving productivity in rural as well as in urban areas.

Again, I thank you for this opportunity on behalf of CyCare and ITUG. We hope that my comments would prove helpful in this endeavor.

Mr. TAUKE. Gentlemen, thank you.

Mr. Wirth.

Mr. WIRTH. I want to thank you both for being here.

Historically, in the process of developing H.R. 5158 and in trying to get a lot of perspectives, we have had an extremely difficult time getting users to surface, to come out and make their interests very clear. For what reasons, I think, there are a lot of obvious reasons for that. Every user that predominantly uses Bell equipment and there were some conflicts of interest within companies, and I just wanted to comment on the fact I really appreciate your being here and the fact that there is an Iowa Telephone Users Group. I wish we had that all across the country to have that perspective.

What do we have this telecommunications system for anyway? To serve 230 million Americans. That is what we are there for and while we make sure that the company remains strong and viable and do everything possible there, it is to serve 230 million Americans, whether it is the proverbial little old lady in tennis shoes or small businesses or very large corporations.

A couple of comments on the statement that you made, Mr. Mills: One on the competition issues which you touched upon at the end. Are we going to have full and fair competition? There is an issue that has not been aired at this hearing but which we will be doing more on, and that is the relationship between the new parent A.T. & T., the relationship between regulated Bell long lines and unregulated Western Electric. And the cross-subsidy issue there, which is very familiar to the subcommittee but not familiar in this particular structure. I mean the question of can they use regulated revenues or where is their potential to use revenues from regulated activities to subsidize your unregulated activities creates a series of issues that have to be addressed if, in fact, we are going to have a really competitive marketplace and not one where the playing field tilts one way or another.

Clearly, in the past it tilted against Bell, you know, their not being able to get into computers and data processing and so on. And I think we have rectified that. We don't want to have the pendulum swing too far.

You also touched on regulatory reform. I think you did, Mr. Cleveland, talking about the certainty and the speed of the FCC in operating. That is another area we really haven't touched upon today. There is a whole section in H.R. 5158 which is devoted to, strange as it may seem, giving the FCC the authority not to regulate. That sounds like a double negative but right now under the law, the Communications Act of 1934, the FCC has to regulate everything under the law. And what we have attempted to do in H.R. 5158, for the purposes of deregulation, is to identify those areas that are important bottlenecks, where there is a scarce commodity and where the marketplace isn't working yet, and that is the places where the FCC should regulate but as we heard today, there are lots of place where you shouldn't deregulate like Iowa has done, and Minnesota has done and so on, and we give the FCC for the first time the authority not to regulate which I think will be welcome and get rid of a lot of the stuff that they do that isn't necessary.

Just finally comment on getting the conference, you note at the end of your testimony, Mr. Cleveland, that you would hope that when we get to conference with the Senate, that we don't lose a lot of the good material that is in H.R. 5158.

I've got two comments on that: The first one is we have to get there, right? We have to get a bill through the subcommittee and through the full committee and to the floor. I wish I shared that assumption. I am very hopeful that we are going to get there. I think we have a lot of momentum and an awful lot of the people in the country terribly concerned about this. It is very important that we do get to conference.

Second, when we do get to conference, I suspect that the virtues of H.R. 5158 will be so overwhelming that our brethren in the Senate who saw fit to support S. 898 by a vote of 98 to 4, I think, or 93 to 4, including your two good Senators from the State of Iowa, would see the light and come over to the side of virtue, right, analysis, futurism.

Mr. CLEVELAND. I don't know whose assumption is worse, mine or yours.

Mr. WIRTH. I am not a political animal in any way, shape or form, Mr. Cleveland. I wouldn't want to comment on that, but that is the process that we have to go through. There were only four Senators who voted against S. 898. It was before the issue was really out there and we have bent over backward on the subcommittee, and this is why we are having this hearing and have had hearing after hearing after hearing, and Mr. Tauke has been deeply involved and probably the most loyal member of the subcommittee coming to all of these, and really getting a sense of the complexity of this. We haven't gotten anesthetized yet by these lengthy hearings and we still learn an enormous amount and I have learned a lot today.

I thank you very much for coming.

Mr. TAUKE. Gentlemen, just for the record, perhaps it would be worthwhile to say a bit more about ITUG. Is it just large users? Is it small users? How many people are in the group, and so on?

Mr. CLEVELAND. Basically it is for all users. It is basically for business users. We have them all the way from where I think we had discussed some of those small telephone companies where they have two telephones and one line, all the way to large Centrex users, large dimension users, big switches. It runs the gamut, I think, probably everything from one phone all the way up to very, very large installations.

We have approximately, I believe the last was about 80-some companies that are members at the present time. We have been, as we have said, in actual business for about 12 months. We are into the 13th month now. We have seen the interest grow because the people that have joined and the companies that have sent people, I think it was brought out earlier, that most of them or all of us were novices.

One morning somebody came in, usually the president of the company to somebody and said, "By the way, I have got this huge phone bill and I got to have some help with this. It is your job; analyze it."

Now, the fellow, he didn't know how to read it, let alone analyze it. About this time was when ITUG was formed to help one another understand how do you analyze it, what is available? To exchange information. It has continued to grow. The organization, every meeting we have, which meets once a month, we take in new members that hear about us and come in. We have speakers that present—we have had Bill make presentations. We have Interconnect make presentations. We have had staff from the ICC make presentations. This month we have the ICC commissioners, themselves, making a presentation.

Mr. **Tauke**. Very good.

Well, gentlemen, thank you very much for your testimony.

Mr. **Wirth**. I wonder if I might exercise the chairman's prerogative at this point. We have about 12 more minutes before we turn into a pumpkin and head off for the airport.

There are a great number of people here, Tom, who have been very patiently sitting through this and listening.

Mr. **Tauke**. I think you are taking the words right out of my mouth.

I was going to say this concludes the formal testimony. But, I know there are some in the audience who had desired to testify. We do have an ability for all of you to submit written testimony for the record that will be part of the committee record. Some of you may have comments that you would care to share now.

Is that OK with you, Mr. Chairman?

Mr. **Wirth**. Yes; or questions.

Mr. **Tauke**. Anybody have any questions or comments?

Mr. **Kelly**. My name is Mike Kelly. I am the director of marketing for North State Communications System out of Minneapolis, Minn., and we do business in six surrounding States here in the Upper Midwest.

Several points which haven't specifically been addressed: First of all, I think that the consent decree has created a lot of confusion and I think it is the confusion here, I think, that requires a lot of expediency on the part of Congress to take legislative action at this point.

We are not concerned as an interstate company doing business in the next 5 years, the next 6 years, the next 8 years, by virtue of our size as opposed to the size of A.T. & T. The size of A.T. & T. has advantages as well as disadvantages. For a smaller company, there will always be a marketplace for companies who have a demand for higher technology items that may or may not be economically feasible for A.T. & T. to offer. But the next year is what we are concerned about.

It is a significant investment, a significant decision for people to make right now about a telecommunications system of any size as Mr. Cleveland can certainly testify through his users group, and the confusion issue here is creating a lot of indecision and keeping the decision process from being as expedient.

Another issue that we are not clear on is the issue of Centrex. Centrex by virtue of its offering is a very significant offering because of the people that are using it. It is all large Government and large business, for the most part. The issue of Centrex and the serviceability of it is only being provided by the local operating company under the consent decree and the common equipment stays with the local company. The local company is a loser on both sides of the issue of Centrex because the common equipment on the customer's premises susceptible to A.T. & T. if the operating company keeps that desired package. If they give up any of it, A.T. &

T. is going to sell it out anyway, therefore stranding central office capacity, causing price and cost spirals increasing local rates.

This is another significant issue that we are looking for.

The issue of Yellow Pages and inside wiring, it appears from our perspective to be a bargaining chip for A.T. & T.; $1 billion is the amount from the Yellow Pages out of the $40 billion that is supposedly at issue here, it doesn't appear to me to be the significant issue. I would hate to see bifurcation and that issue being bargained for with Yellow Pages being the bargaining chip. Because it doesn't appear to be significant to the $60 billion in assets that A.T. & T. is walking away from the table with. And basically I apologize for not having more well-thought-out thoughts on the issues, but these are some of the things that I wanted to raise as issues. Thank you.

Mr. TAUKE. Who do you say you represent again, sir?

Mr. KELLY. North State Communication Systems headquartered out of Minneapolis, but we have sales offices in Wisconsin, Iowa, Omaha, South Dakota, North Dakota, so we see every aspect from industrial in Milwaukee to high tech in Minneapolis to agribusiness in Omaha, Sioux Falls, Iowa. And these seem to be the key issues that we are hearing from all customers of all types.

Mr. TAUKE. Do you plan to submit any testimony to the subcommittee?

Mr. KELLY. I certainly could. Is there an address that it could be forwarded to?

Mr. TAUKE. If you stop up here, we will give you a card with the address on it.

Mr. WIRTH. The second issue you raised, the Centrex issue, is one that I think we explored pretty thoroughly with Mr. MacAllister earlier in the day, you know, who walks away with what and how do you divvy this up, what happens to local operating companies and how do we get a clear picture of that. It would be very helpful to get your comments on that.

The third issue you raised of yellow pages, and the bargaining chip, I would put yellow pages in a number of categories in terminal equipment that you mentioned. One, how does inside wiring get treated? What happens in terms of asset evaluation, what happens with the access charge, are major components of which yellow pages, you are quite correct, is one. Whether Bell is using that as a bargaining chip, or not, I think it is difficult to say.

Finally, on the expedition question, the first point that you made, we certainly are going to have to have your help and that of others in impressing on our colleagues in the House the need for moving expeditiously on this. The issue is not going to go away. A lot of people in the Congress would like to see it go away because it is enormously complicated and it would be easier not to have it around, right? Then they wouldn't have to deal with it. I understand that. But it is going to be around for a long time overall, because we are in this telecommunications revolution.

What we want to do is to get you to help us and others to help us talk to other Members of the Congress from Iowa and Minnesota and elsewhere to help bring them up to speed on these issues. You can help us an enormous amount on that. There is a big education job to do here on these issues that are as complicated as the ones in front of us.

Mr. **Tauke**. Another hand in the back?

Ms. **Whelock**. I am Janice Whelock and I am representing the radio common carrier industry. Our particular concern is that H.R. 5158 does not deal directly with the radio common carrier industry. The terms of exchange, interexchange, and SMSA; radio common carriers fall under or around all of those descriptions and we would just like to know if you do plan to be a little more definitive about radio common carrier industry?

Mr. **Wirth**. We have had extensive meetings with the radio common carrier people over the last 6 weeks and as I said when I introduced H.R. 5158, this is not a perfect piece of legislation by any means. We put it so-called out on the street so everybody could look at it. We have had an enormous amount of input and comment from people and radio common carriers have been in and we are working with them in an attempt to resolve the problem you are talking about. Just as we were talking earlier with the rural people about some of the ambiguities in the legislation and, you know, trying to write something as complicated as this, we need all the help we can get. We don't have anybody anywhere near a corner of the expertise. You know, that is why we have hearings and that is why we spend the enormous amount of time that I think we have with a very, very open door.

So I know that those discussions are going on. I think we are close to resolution on that. To the radio common carriers and others, you know, the concerns that you have, we would really like to hear from you. The door is open and we want to have that ability to write the best piece of legislation we possibly can, with as few ambiguities in it so there is as little court involvement or as little regulatory ambiguity as possible, Mr. MacAllister.

Mr. **Kay**. My name is Francis Kay and I work for Northwestern Bell as a systems tech and I am here on my own time because I am concerned and I just hope that we don't fail to realize what A.T. & T. has done for this country. We talk about so many things and there are things that A.T. & T. originally initiated, satellites, TelStar, all the things that A.T. & T. has done and as an employee of Northwestern Bell, I have taken pride in my job, I have taken pride in my service.

I look around the room and I see all these pictures and there is one picture that is lacking and that is called the "Spirit of Service," and I hope we don't fail to realize what A.T. & T. has done for this country.

Mr. **Tauke**. I think that is a very good point. In fact, the first thing that I wrote down on my yellow pad when I walked in the room this morning and Mr. MacAllister testified was "best telephone system in the world," and we in this country have had the good fortune of having the best telephone system in the world for the past many years.

Now, changes are occurring in that system, many of which we don't have control over and I suppose that our mission, as we see it, is to help maintain this system as the best telephone system in the world, a system which provides universal service to the people of the Nation at a reasonable cost. That is what A.T. & T. has done for the past *x* number of years and we expect that and hope that that is what we will be able to continue to maintain in the years ahead. That is an excellent point.

Yes, sir.

Mr. KILBURG. My name is Roger Kilburg from the Preston Telephone Co. in Preston, Iowa. We are a very small independent company and I am sure I am quite unqualified to speak to the specifics as much as what has been addressed today.

But as I try to keep up on this, in a small company you are dealing with so many things it is hard to devote the time to much of the legislation and the actions that we should. But as I have tried to keep up a bit on this, what keeps coming to mind is what you are actually doing is revising—in my understanding, anyway—revising the Communications Act of 1934. My understanding of history on that is that it was originally created to fill a need for rural and urban areas that were not being served because it was not competitively feasible, was not cost feasible to serve these areas. Of course, in the larger areas, it was overservice where you had six or eight telephone companies and you had to have a rural telephone to call everybody that you wanted to call.

But what I am concerned about is that Washington is going to forget about the needs of the rural people as well as the rural telephone companies trying to serve the people. Our costs for providing service are a lot higher and there are many areas. One example is toll. If toll is deregulated I can't see how a small company like us is going to be provided toll service without a drastic increase in cost.

We haven't had the MCI's beating down our door to serve an Iowa town with a population of 79. You know, if there is no requirement that we be allowed access to the main network, I fail to see how we are going to be allowed access. Or if we are allowed access, that whoever will provide it will say:

> The costs are so high per message that you are going to have to absorb much of that cost. We are not going to be able to provide at the same rate we can provide Chicago or Los Angeles, Des Moines, Davenport.

The result is going to be that our percentage of revenue per cost of providing a toll message is going to be so high we are either going to—we are obviously going to have to provide it so we are going to have to make up the revenues to keep in business by either local service or some other form. So I guess, I don't know, in summary I think it would be important to realize you are changing the Communications Act of 1934, and what it originally tried to do. Are you going to undo that, you know, with respect to involving rural Iowa and the rural country, as a whole? Thank you.

Mr. TAUKE. I don't think that as a general rule that we want to undo what was done in 1934, at least in terms of the intents and the purposes of that act. What we are trying to do is maintain those same purposes but apply them to a changing world.

It occurs to me that the fact that the first hearing that is being held outside of Washington is being held in Iowa, the State that has the most independent telephone companies. The fact that the chairman of the subcommittee who probably would prefer—maybe I won't say prefer—but who could well be spending his hours doing something that doesn't relate to the business of Congress or could be doing it traveling in the new territories of his newly revised district in order to become acquainted with those people but he chose to take the time, instead, to come to Iowa primarily because of the unique situations that we face here.

I think that is an indication that the interests of Iowa are not being forgotten and the interest of the small telephone companies aren't being forgotten. We know that an integral part of that world's best telephone system has been the service of the various independent telephone companies that have served our State so well. I can assure you that there is at least one member and I believe I can there are two members here this morning who are bound and determined that the small telephone companies will be dealt with in a fair way in this legislation.

Mr. WIRTH. Let me just add a couple of points to that.

I think it is very important to step back and say what are we trying to accomplish and where are we trying to go. One of the purposes as you point out, of the Communications Act of 1934, was to provide service to everybody in this country. It was a goal at a price they could afford. All right, it was a public interest, convenience and necessity standard interpreted to do that. And we have done that very successfully, beyond probably anybody's wildest dreams. The system has been remarkably good.

Are we going to turn our backs on that? Absolutely not. There is an underlying and continuing commitment in the country to make sure that rural America has access to and is involved with the mainstream of American urban life and that American urban life understands what is going on in the mainstream of American urban life and that American urban life understands what is going on in rural America. We are a very diverse country and have always rejoiced in that diversity. That has been one of our enormous strengths and we want to continue that.

I think philosophically that commitment is very, very clear there and I don't know of very many people who don't at least theoretically share that.

The substance of the legislation also reflects that commitment, with the access charge, with the National Telecommunications Fund. Those concerns are clearly reflected in the legislation. And your trade group, all of the rural telephone companies, have been enormously helpful in clarifying and identifying your interests and as representatives of that group were testifying today, we have consistently had them and they know that our door is open in the subcommittee in terms of drafts and concern.

Finally, I would just underline all of this with just the reality of the politics of the situation. Remember that Tom Tauke represents the State of Iowa with 160 rural telephone companies. The reality of the situation is that he is going to pay attention to 160 telephone companies.

I represent an area of the country, as I said earlier on, 25 percent of the land mass of the country in the Rocky Mountain region, and 3 percent of the population. I wouldn't be a member of the Congress very long if I weren't assuring that that part of the country was tied into the system.

Finally, maybe the ultimate reality, is what is called the rural caucus in the Congress, which we have worked with very carefully to reflect their concerns which are the same as your concerns, deeply involved in all of this.

The point is well taken to continue to emphasize that in that set of goals and it is one that I share, it is one that Tom Tauke shares and it is one that I think is broadly shared in the Congress. I can't speak for congressman from Brooklyn, but some of them go for the agricultural extension service.

Mr. KILBURG. I misrepresented what I actually meant.

I appreciate you gentlemen coming here and doing what you are doing and I guess what I am reacting to is that we get daily floods of information from Washington, whether it be the FCC or the Department of Justice and it seems like we are not represented there.

Mr. WIRTH. You don't vote for the FCC, you don't vote for the Justice Department. Congress is the place that is accountable. That is, going to back to what we said starting out today, where public policy ought to be set, by the Congress of the United States. That is what Congress is in the Constitution to do. You are around to help us do that in the best possible way we can.

Mr. TAUKE. The Congressman has to make a mad dash to the airport. I want to thank him, personally, and thank all of you for coming this morning.

On the wall of the Cedar Rapids Municipal Airport is a sign which says, "Cedar Rapids, the telecommunications capital of the world." And this morning I think that we enhanced our reputation just a little bit in that area.

Certainly this has not been an exhaustive hearing but it has been one that I think did touch on some of the issues that are of primary concern to Iowa. I know that many of you are going to have additional questions and comments as the days and weeks unfold between now and the time this legislation is approved. I hope that you will feel free to get in touch with our office at any time during the next several months in order to communicate your views. Thank you again.

[Whereupon, at 12 noon, the subcommittee was adjourned.]

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PROPOSED A.T. & T. ANTITRUST SETTLEMENT

WEDNESDAY, FEBRUARY 17, 1982

House of Representatives,
Subcommittee on Telecommunications,
Consumer Protection, and Finance,
Committee on Energy and Commerce,
Washington, D.C.

The subcommittee met at 9:45 a.m., in room 2322, Rayburn House Office Building, Hon. Timothy E. Wirth (chairman) presiding.

Mr. Wirth. The subcommittee will come to order.

Thank you very much for your patience. The Congress as you know is officially not in session this week. There are a number of members of the Commerce Committee who will be coming back and forth during the hearings today while the clean air hearings are going on downstairs. I suspect there will be a great deal of competition for members, particularly since there are television cameras downstairs and not upstairs.

This morning we begin 9 days of hearings on H.R. 5158, the Telecommunications Act of 1981, and, more generally, on the need for legislation in light of the proposed settlement of the Justice Department's antitrust suit against A.T. & T. Of course, we have asked the witnesses who will appear before the subcommittee this month to address the issues raised by the settlement itself.

The settlement resolves the issue of the relationship between the local operating companies and the rest of A.T. & T.—an important structural question—but it fails to address a long list of other problems, and it raises some new questions as well.

The settlement has brought into sharp relief such issues as the continued availability of telephone service at reasonable rates; the maintenance and improvement, particularly at the local exchange level, of our telephone system's high quality; and the development of full and fair competition throughout the telecommunications industry. It is our purpose here today to examine the settlement's effect in each of these varied areas.

There is, in addition to these issues, a need to overhaul the FCC's regulatory machinery to keep pace with the rapid developments in telecommunications. The definition of Federal and State regulatory jurisdiction must be clear. Despite the dramatic changes required by the settlement, it does not—and cannot—change the FCC's jurisdiction, or enable the Commission to deregulate competitive markets.

Of course, the antitrust settlement did not create the local rate issue, or the need to maintain high-quality telephone service, or the desire to encourage competition. All of these issues predated the settlement. We have been seeking solutions to them now for years. But the settlement has served to focus the issues for debate, and its short-order timetable makes resolution of those issues imperative.

As with any plan so complex and far reaching, there are details and ambiguities in the settlement that the parties and the court must still resolve.

There are those who say that, consequently, Congress should refrain from taking any action now, that we should wait until the settlement is in final form, but many of us on this subcommittee, including myself, disagree.

I believe today, as I have since becoming involved in these issues, that the Communications Act of 1934 must be revised to serve in the coming decades as the underpinning for universal telecommunications service and the development of competition in this industry. Congress has the responsibility to establish policy in this crucial field—regardless of court action. I am confident that we will act this year.

Members of the committee, thank you very much for being here. Before we proceed, Mr. Markey, do you have a statement you would like to make?

Mr. **Markey**. Yes; thank you, Mr. Chairman.

Mr. Chairman, I really was not surprised to read in yesterday's Wall Street Journal that the Reagan administration will oppose the responsible legislative efforts of this subcommittee to protect consumers from A.T. & T.'s feared ability to "reach out and crush someone."

Frankly, I question opposition to any further structural safeguards to separate monopoly activities of one side of a company from the competitive offerings of that same company. I feel that the administration decision flys in the face of this administration's call for increased productivity, employment, and innovation.

What this administration has asked the American consumer to do is sit tight and trust the Justice Department antitrust safety net to protect them from the potential cross-subsidies flowing from captive ratepayers to A.T. & T.'s lucrative endeavors. This shows me that:

The administration really does not care about consumers; the administration does not believe in a free market for the emerging new computer and data processing services; the administration does not care about the contribution of high technology to productivity, innovation, and employment—particularly in the New England region.

I guess I really should not be so incredulous. After all, this is the same administration that gives a $12 billion tax break for the big oil companies while eliminating hot meal programs for the elderly. These are the same distorted priorities.

But what does surprise me is that this administration seems to be looking out for the interests of one company exclusively—A.T. & T. Last week our colleague, Mr. Mottl, charged the company with being able to consider the Justice Department one of its greatest assets. Well, my friend was only half right: A.T. & T.

should also claim the Commerce Department, the Defense Department, and apparently the White House.

I look forward to hearing from the administration spokesperson, the Assistant Secretary of Commerce, Bernie Wunder, and his defense of these administration policies, and from the FCC Commissioners who are here this morning. Thank you, Mr. Chairman.

Mr. WIRTH. Thank you very much, Mr. Markey. To the Commissioners, thank you very much for being here.

Mr. Fowler, we are delighted to have you here. I am hopeful we will be able to have you summarize your testimony and then we can get into questions and answers with the members of the committee.

STATEMENT OF MARK FOWLER, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION, ACCOMPANIED BY COMMISSIONERS JOSEPH FOGARTY, ABBOTT WASHBURN, HENRY RIVERA, JAMES QUELLO, ANNE JONES, AND GARY EPSTEIN, CHIEF, COMMON CARRIER BUREAU, AND ALBERT HALPRIN, CHIEF, COMMON CARRIER BUREAU'S POLICY DIVISION

Mr. FOWLER. Thank you very much, Mr. Chairman.

Mr. WIRTH. As always, we welcome you to appear before the telecommunications subcommittee.

Mr. FOWLER. We are pleased to be here. Mr. Chairman and members of this subcommittee, with me today are FCC Commissioner James Quello, Abbot Washburn, Joseph Fogarty, Anne Jones and Henry Rivera. Also here are Gary Epstein, Chief of the Common Carrier Bureau, and Albert Halprin, Chief of the Common Carrier Bureau's Policy Division.

Thank you, Mr. Chairman, for giving us this opportunity to testify on H.R. 5158 and on the effects of the recent proposed settlement of the A.T. & T./Department of Justice antitrust proceeding. The terms of H.R. 5158 and the proposed A.T. & T. consent decree are evidence of an emerging consensus that telecommunications competition, free from the constraints of unnecessary or inappropriate regulation, is desirable and in the national interest.

I and my fellow commissioners join in this consensus. I welcome structural and other approaches, whether legislative or antitrust-initiated, that further the development of full and fair telecommunications competition.

The Federal Communications Commission is committed to deregulation of competitive telecommunications markets. We believe that the interplay of competitive market forces can best determine the services that should be available to the public. For this reason, the FCC is strongly promoting new entry and the development of new services.

And, when deregulation is not yet possible, in markets where competition is still developing or where competition is imperfect for reasons beyond the FCC's control, the FCC is committed to regulatory improvement and development of transitional measures that promote the development of competition.

The proposed consent decree separates regulated bottleneck local Bell Operating Company services, such as local exchange service, exchange access and additional monopoly offerings made under tariff, from the reconstituted A.T. & T. The agreement provides that the BOC's cannot discriminate in interconnecting interexchange services offered by A.T. & T. and its competitors. The new A.T. & T., stripped of control of these bottleneck facilities, may engage in telecommunications services, terminal equipment offerings and unregulated activities without restriction under the proposed decree. To implement the agreed upon division between A.T. & T. and BOC activities, A.T. & T. will be required to divest its ownership of the BOCs to A.T. & T.'s underlying shareholders.

The FCC has been scrutinizing the proposed decree during the last 6 weeks. We are seeking to determine how its terms mesh with our pro-competitive views and public interest mandate. I have reached two overriding conclusions:

First, Congress has charged the FCC with implementing the public interest mandate contained in the Communications Act of 1934. The consent decree cannot alter that independent responsibility. We intend, above all, responsibly to protect the public interest in the new environment created by the decree.

Second, the voluntary agreement of the Department of Justice and A.T. & T. is, I believe, a positive step toward promoting new forms of competition. Therefore, I endorse removal of 1956 consent decree restrictions upon A.T. & T.'s activities. I intend to urge the Commission to facilitate implementation of the decree insofar as, in its final form, it embodies and is consistent with our public interest goals.

Will these conclusions translate into FCC action? Yes, in many ways and in different forums.

First, recognizing the independent sources of jurisdiction of the FCC and the Department of Justice, the FCC intends to work closely with the Department of Justice to address issues raised by any ultimate divestiture plan. I note that the Competitive Impact Statement released by the Department of Justice last week indicates that the Department intends during the period prior to submission of a divestiture plan to work closely with the FCC and other parties. We are attempting to develop that relationship so that our input becomes an integral part of the divestiture plan.

Second, the FCC will file an amicus brief and a Tunney Act submission that will focus on the specific provisions of the proposed decree that we support and those about which we may have reservations.

Third, the FCC will continue to cooperate on legislation to address telecommunications policy issues which predate the proposed consent decree—or which develop in its wake.

Fourth, the FCC will continue to develop its procompetitive policy initiatives. Our decisions in computer II and in many other dockets further the cause of deregulation in the public interest. I believe that the consent decree is consistent with the direction taken in our decisions. We shall scrutinize changes resulting from the judicial process under our statutory mandate.

We plan to take these steps in a spirit of consensus and in recognition that the remaking of the world of telecommunications for the 1980's and beyond will require dedicated effort from both the public and private sector. Reaching an agreement on national telecommunications policy will benefit the American public.

Again, I emphasize the importance of the consent decree to such a consensus. At the same time, I underscore that the FCC, as part of its independent public interest mandate, will insure that any ultimate policy consensus under our control be one with all voices heard.

The central terms of the consent decree are laudible. By separating Bell System local exchanges from its long distance entity, the decree changes corporate incentives in pro-competitive ways. Local operating companies will no longer have the same incentives to favor A.T. & T. Long Lines for interconnection of service or to buy-Western.

My fellow commissioners and I do have certain reservations or questions about the decree. We hope these can be resolved to the satisfaction of all concerned. The FCC is not convinced that the new local exchange carriers which develop as a result of the decree must forever, and in all circumstances, be limited to the offering of regulated service.

Granted, local exchange service is today a monopoly bottleneck. But, if there is one truism about the telecommunications industry, it is that new technologies are developing quickly in unforeseen ways. We at the Commission, faced with a 1956 consent decree which, in my opinion, could have deprived consumers of some of the benefits of competition and innovation, as well as hampering this country's ability to compete in the ever-expanding world marketplace, are very sensitive to this issue.

We think that, at the very least, the decree should recognize these facts of telecommunications life. It should either sunset these provisions after a given period of time or provide the court with a mandate to reexamine, at regular times, whether the prohibitions on BOC competitive activity and interexchange service are warranted and to eliminate any restrictions on the BOC's which are no longer justified. The Department of Justice has expressed willingness to explore ways to address this issue.

The consent decree also gives rise to difficult issues of cost allocation, involving instances when, at present, equipment used for both exchange and interexchange service is integrated and when accounting for assets is similarly integrated.

To offer an example, the proposed decree prohibits the BOCs from providing interexchange services. In terms of A.T. & T.'s existing telephone network hierarchy, it generally allows A.T. & T. to retain ownership of so-called class 4 offices, which are the first level of long distance switching facilities, while requiring the BOCs to retain ownership of class 5 offices, which are local exchange switching facilities owned today either by BOCs or independent telephone companies.

However, in many cases the two hierarchical switches are contained in the same machine. Because A.T. & T.'s competitors require access to the BOC's facilities, misapportionment of costs in this technologically-integrated environment would distort competition.

On the accounting side, significant cost determination and apportionment issues must be resolved because much of the interexchange plant which must be transferred to A.T. & T. under the proposed decree is today owned by the BOCs. I believe that this can be accomplished. I want to make it clear that the FCC's authority under the Communications Act to determine costs of facilities used for interstate services for ratemaking purposes is unaffected by accounting associated with implementation of the settlement.

It might also be noted that preliminary analysis of the decree performed by our Common Carrier Bureau staff indicates that a change in the proposed consent decree might clarify the relationship of the decree to the FCC's jurisdiction. Specifically, the staff has suggested that a provision expressly recognizing that the antitrust decree does not impinge on the jurisdiction of the FCC be inserted in the decree.

Although I do not believe that such a modification is absolutely necessary in light of Congress' explicit grant of powers and authorities to the Commission, it would reduce the possibility of useless and resource wasting administrative or judicial procedures. This device, known as a terminal railway provision, was first employed in an antitrust decree involving an ICC-regulated railroad.

One much discussed topic is the effect of the proposed decree on local rates. Local rate levels, as you know, involve complex interrelationships. The Common Carrier Bureau staff's preliminary analysis of the effects of the proposed decree indicates that the local rate question, while an important issue, is not directly affected by the decree. It is other pressures such as inflation, increased depreciation rates, terminal equipment deregulation, changes in separations, and expensing of station connections that are involved.

To the extent these are FCC mandated policies, we believe that they responsibly respond to the technological revolution in the telecommunications industry. In taking such steps, we have repeatedly underscored our concern about local rates and have implemented our policies in a manner designed to avoid massive disruption or dramatic rate increases.

The decree will not necessarily produce any substantial effects on local rates if the divestiture is accomplished through a fair implementation plan. However, a reorganization plan which is not properly conceived could affect the divested BOCs in a manner that increases their capital costs. This effect could be reflected both in local exchange rates and in access charges.

Additionally, loss of yellow pages revenues could have some direct effect on local rates although, it appears that the issue of whether local exchange companies can use these revenues to keep local rates down will be resolved.

Under the Communications Act, the FCC has jurisdiction over interstate services end-to-end, including the local exchange portions of interstate telephone calls. Local concerns will be appropriately weighed through specific statutory mechanisms such as Federal/State joint boards, consultation with State regulatory agencies and participation by the States in FCC proceedings. I want to emphasize the point that quite clearly access charge tariffs contemplated by the decree will be filed with the FCC, under its jurisdiction.

Local exchange compensation currently is determined at two levels. First, the Federal/State Separations Manual apportions costs to the respective jurisdictions. It does so in a way that assures that interstate costs are significantly higher than they would be based on strict relative usage measures.

Second, A.T. & T. divides joint revenues on a contractual basis with local exchange carriers, including both BOCs and Independents. This process, known as division of revenues or settlements, covers such carriers' particular costs through a pooling arrangement which guarantees local carriers equal rates of return on their interstate investment. This process is subject to FCC jurisdiction under the act.

The FCC and the States, through Separations Manual procedures, have sought to increase the assignment of local exchange costs to long distance services. While this has been thought of as a subsidy from interstate services, it might be noted that assumption of additional costs by the interstate jurisdiction has been justified on a number of grounds, including payment by interstate subscribers for the value associated with the ability to reach more telephones.

Measured use plans—such as those already adopted by several jurisdictions—can also keep down the local charge entry fee to the network. Lifeline rates have also been used to insure the universal availability of basic service. These questions involve ratemaking authority which is properly reserved to the States, not the FCC, but reasoned discussion of the local rates issue requires that they be raised.

I would note that under existing law as well as under the jurisdictional restructuring that would take place under H.R. 5158, State commissions have considerable authority over the level of basic local service if fears of massive customer disconnection from the network are realistic.

The mechanism of the proposed consent decree for compensating the BOCs for their participation in interstate calling is one of access tariffs, rather than the present A.T. & T./BOC division of revenue contractual procedures. I do not believe that such a change of the mechanism, from one of private contract to one of tariff, would necessarily change current results.

Access charges for interstate services under existing law will reflect the exchange plant costs which are allocated to the interstate jurisdiction under the Separations Manual, and local exchange rates will continue to reflect the remaining costs allocated to the intrastate jurisdiction.

Now let me turn to the other subject of this hearing. H.R. 5158 is a comprehensive revision of the common carrier provisions of the 1934 Communications Act. It seeks to accomplish a number of goals to which the FCC has long been committed. It states a procompetitive statutory purpose, granting the FCC authority to exempt competitive carriers and services from regulation. More generally, it seeks to adapt 50-year-old legislation to realities of telecommunications in the 1980's. I agree with and support these goals.

It is very likely that the 1956 Decree will be superseded in the near future, either by the terms of the A.T. & T./Justice Department settlement or by some variant thereon. Thus, legislative revision of the common carrier provisions of the Communications Act need no longer concentrate on difficult issues concerning A.T. & T.'s structural links with its operating companies. I believe that we most profitably should address telecommunications issues on the assumption that the BOCs will be divested, and that

A.T. & T. will be free to compete with others in a broad range of new activities.

The agreement by A.T. & T. to divest its local exchange companies is a far-reaching decision. It may well resolve some of the regulatory issues which long form legislation is designed to address although I recognize that difficult public policy questions with respect to separations and the mechanics of access charges, which existed prior to the antitrust settlement, have not disappeared.

It is my view however that Congress should at this time carefully analyze the consent decree and its potential affect on the shape of the telecommunications industry as the Tunney proceedings unfold. After Judge Greene completes his Tunney Act proceedings, Congress will be in a better position to decide what comprehensive revisions of the Communications Act of 1934 are needed.

At the same time, I do believe that some changes to the 1934 act could not only achieve broad-based support but also largely ameliorate residual problems and new ambiguities which might be introduced by the decree. Accordingly, I do think it appropriate for Congress to consider at this time short form legislation which would include the following provisions:

First, explicit authority should be granted the FCC to exempt carriers from the title II provisions of the act and to forebear from regulation. This would ameliorate uncertainties surrounding appellate review of the Commission's computer II decision not to regulate enhanced services, and could clear the way for substantial deregulation of nondominant carriers. I would propose that the FCC continue to exercise such authority through rulemaking, subject to comprehensive evaluation of specific deregulation proposals.

Second, a statutory presumption that the public interest favors competition, rather than regulated monopoly, should be stated. This would place the burden squarely on the proponents of continued regulation in any such deregulation proceeding, or in licensing/certification proceedings involving additional entry in telecommunications. It would maximize opportunities for carriers to compete in the marketplace.

Third, clarification that the FCC retains authority over the separated BOC to prescribe jurisdictional separations may be desirable. Such authority is inherent in the FCC's authority over interstate rates, and in sections 201-205 of the act to which connecting carriers are specifically subject.

Nevertheless, legislative pronouncement would avoid the uncertainties associated with possible judicial appeals of future revisions to the Separations Manual or necessary accounting changes based upon jurisdictional grounds.

Fourth, Congress should grant the FCC jurisdiction over all interexchange services, including intrastate toll historically subject to State jurisdiction. The arguments made in favor of such a transfer during the course of the H.R. 5158 debate apply with even greater force in the environment of the decree, with its A.T. & T./BOC split generally founded upon an interexchange/exchange activity split. Moreover, it makes more sense for A.T. & T. to be regulated, in the new environment, by a single FCC, rather than by the FCC and State authorities.

Before closing, I want to discuss briefly FCC preparedness after entry of the consent decree. Key areas for continued FCC efforts are access tariffs and development of safeguards to ensure that A.T. & T. services paid for by American ratepayers do not subsidize its competitive endeavors.

We have the expertise at the FCC to develop, in conjunction with state representatives, access charge mechanisms consonant with the consent decree and our own public interest goals. I cannot predict whether access tariffs will ultimately be filed on an aggregated basis as they are now, or on a disaggregated basis, with a filing for each local exchange.

The FCC recognizes that under either scenario it retains both the authority and the responsibility to ensure that access charges for interstate services are just and reasonable, and not unlawful or discriminatory, consistent with the Communications Act.

If the consent decree takes effect, the FCC believes that the protections against cross-subsidy of competitive services by the customers of rate-base regulated services should remain at this time. Our computer II decision is the framework for this protection. I am proud to say that the FCC's computer II refinements, made since I last testified before you in the fall, have contributed to development of a telecommunications policy consensus. The Common Carrier Bureau has assembled a group of experts to implement computer II. I am confident that at projected levels of funding the FCC can accomplish the task.

In sum, I believe that we will be entering a new environment as a consequence of the A.T. & T./Department of Justice settlement, if it is implemented. Certain of the very difficult problems addressed by H.R. 5158 are solved by the proposed decree. Conversely, new problems may be created by the decree which may require legislative solution. We of course are prepared to work with the Congress in the development of telecommunications legislation to address these problems.

I would be happy to answer any questions.

[The following letter and memorandum was received for the record:]

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

February 18, 1982

IN REPLY REFER TO

Honorable Timothy E. Wirth
Chairman, Subcommittee on
 Telecommunications, Consumer
 Protection and Finance
House Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciated the opportunity to appear before you yesterday at the Subcommittee's hearings on the AT&T/Department of Justice consent decree modification and related legislative matters.

I would request that the enclosed memorandum be included in your hearing record as it more fully states my views on certain critical jurisdictional issues presented by the consent decree modification and the related judicial proceedings. In brief, I believe it essential that the FCC's participation in the consent decree proceedings preserve the Commission's independent and primary jurisdiction under the Communications Act and its congressionally mandated responsibility for the formulation and execution of telecommunications policy in the public interest.

Your consideration of this request is appreciated.

With best wishes, I am

Sincerely,

Joseph R. Fogarty

Joseph R. Fogarty
Commissioner
Federal Communications Commission

Enclosure

UNITED STATES GOVERNMENT

memorandum

DATE: January 21, 1982

REPLY TO ATTN OF: Commissioner Fogarty

SUBJECT: AT&T/DoJ Antitrust Proceedings

TO: All Commissioners
Chief, Common Carrier Bureau
General Counsel

The recent "settlement" reached between American Telephone and Telegraph Company (AT&T) and the Department of Justice (DoJ) is of momentous significance for this nation's telecommunications policy in general and in particular, for this Commission's responsibilities and prerogatives concerning that policy. While I am aware that our Common Carrier Bureau is moving quickly to assess this significance and to prepare analysis and recommendations for possible Commission action, I want to share with you some initial thoughts on what I see as certain core issues and concerns.

At the outset, I want to emphasize that while AT&T and DoJ may have reached a reasonable and proper private accord under the antitrust laws, such accord, with or without judicial approval, cannot oust, supplant or modify this Commission's mandate, authority, and jurisdiction under the Communications Act of 1934. Indeed, in cases of irreconcilable conflict it is the antitrust law which must yield to this Commission's broader regulatory jurisdiction. Otter Tail Power Co. v. U.S., 410 U.S. 366 (1973). The reason for the primacy of our regulatory jurisdiction is plain: the Communications Act requires the FCC to base its actions on findings made in accordance with the statutory standard of the "public interest, convenience, and necessity;" by contrast, the antitrust laws look solely to competition as the safeguard of the public interest. Although competition is a component part of our regulatory standard, it is not the whole. This Commission's mandate is not merely to further competition or simply to balance equities among competitors, but rather to determine how best to provide telecommunications service to the public. FCC v. RCA Communications, Inc., 346 U.S. 86 (1953); Hawaiian Telephone Co. v. FCC, 498 F.2d 771 (1974). As the Supreme Court has stated:

> The very fact that Congress has seen fit to enter into the comprehensive regulation of communications embodied in the Federal Communications Act of 1934 contradicts the notion that national policy unqualifiedly favors competition in telecommunications.
>
> . . . .
>
> What may substantially lessen competition in those areas where competition is the main reliance for

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> regulation of the market cannot be automatically transplanted to areas in which active regulation is entrusted to an administrative agency; . . . what competition is and should be in such areas must be read in light of the special consideration that have influenced Congress to make specific provision for the particular industry.

FCC v. RCA Communications, Inc., 346 U.S. at 93, 98.

It is precisely because the standard of the antitrust laws differs from this Commission's statutory mandate that the judicial setting of the new consent decree between AT&T and DoJ raises special considerations of the proper relationship between the FCC and the courts. In particular, the possibility of inconsistent or even contradictory decisions and directions affecting members of the regulated industry must be closely examined from the standpoint of the congressional delegation to this Commission of the primary jurisdiction over telecommunications policy. Principles of judicial and administrative agency economy may also be concerned.

These general comments should not be read as indicating any preconceived views on my part as to the legal or policy merits of the new antitrust consent decree agreed to by AT&T or its consistency with the FCC's mandate and authority. I am aware that the law favors an analysis which seeks to accommodate both regulatory and antitrust regimes. Silver v. New York Stock Exchange, 373 U.S. 341, 357 (1963). I also believe that the larger public interest may be well served by the parties' private settlement of their differences under the antitrust laws. However, I am equally--indeed, primarily--concerned that the Commission take pains to ensure that its existing congressional mandate and regulatory jurisdiction and authority are respected. I am confident that our staff is undertaking its analysis and preparation of recommendations with this perspective firmly in mind.

Turning to specifics, it appears to me that all the major aspects of the new consent decree may involve the FCC's jurisdiction and authority. In making this preliminary assessment, I have drawn heavily on the excellent amicus curiae memorandum filed by the Commission in 1975 in the U.S. District Court for the District of Columbia which has been hearing the AT&T-DoJ antitrust suit. We are fortunate that our jurisdictional views and concerns were entered early on the record in this judicial proceeding.*

(1) Industry Market Structure

The salient feature of the new consent decree proposed by the AT&T-DoJ accord is the divestiture by AT&T of its 22 Bell Operating Companies (BOCs). The potential impact of this proposal on our nation's telecommunications network and the services provided through it may be benign or cataclysmic, but such a dramatic change in telephone industry market structure clearly warrants this Commission's review and comment. The apparent intent and effect of the new decree is to separate completely the BOCs' "natural monopoly" local exchange services from all other AT&T operations, as well as to preclude BOC provision of CPE and "information services" and to limit the BOCs to providing only local exchange service and exchange access. The severance of end-to-end Bell System facilities and service raises questions concerning the continued adequacy of telecommunications network capacity and the continuity of network planning. The consistency of the new decree with the policy directions and the dates of implementation established by the Commission in Computer Inquiry II must also be considered. The prohibition on BOC provision of "information services" impacts the Commission's pending inquiry on cable television/telephone company cross-ownership. The Commission's Cellular Radio decision may also be affected by the new decree.*

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* It should be noted that the Commission's SBS authorization order cited this amicus curiae memorandum as setting out "those limited areas where we believe the antitrust laws have been implicitly repealed by the passage of the Communications Act," 62 FCC 2d 997, 1071 n.133 (1977), and included the memorandum as Appendix A to the SBS decision at 62 FCC 2d 1102-32. The memorandum thus enjoys a full imprimatur of Commission action and precedent and does not merely represent the litigation views and positions of its counsel.

While the Commission's amicus memorandum observed that FCC authority with respect to telephone industry structure is "limited" under the Communications Act, it also stated that:

> The Court should not alter the basic industry structure until the agency has had an opportunity to study the effects of such a change on the provision of communications services. Factual issues relevant to the benefits and drawbacks of possible structural changes should be referred to the agency for its views, for the Communications Act clearly made the FCC the primary architect of communications policy. Structural changes in the industry, of course, could have a significant effect on policy. We believe the doctrine of primary jurisdiction applies here as in other areas as the appropriate means of accommodating antitrust policy with the agency's regulation of communications. In any event, the FCC should be consulted before any possible remedies are seriously contemplated, either by further participation as amicus curiae or by exercise of the agency's primary jurisdiction as fact-finder in communications matters of national importance.

68 FCC 2d at 1118. The Commission's views on the industry restructuring proposed by the new decree and its impact on this agency's developing telecommunications policies are critical and should be heard.

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* These are not the only Commission proceedings involved. Practically every major Common Carrier Docket will be affected.

(2) Section 214 Authority

Directly related to the foregoing matters of industry structure is the question of whether this Commission's Section 214 approval is required to effectuate the BOC divestiture. Based on recent Commission precedent, I believe it is possible for the Commission to assert such authority.

In its 1979 GTE-Telenet Merger decision, the Commission set forth a broad and expansive interpretation of the purpose and reach of its Section 214 authority. In affirming on reconsideration its holding that GTE and Telenet's parent corporation were required to secure prior FCC approval of GTE's proposed acquisition of the parent's stock by filing an application pursuant to Section 214, the Commission reasoned that:

> Section 214 provides the basic framework within which this Commission controls market entry and exit and imposes conditions upon the use of common carrier facilities in exercise of our broad statutory mandate to "regulat[e] interstate and foreign commerce in communication by wire and radio." [citing Section 1 of the Communications Act]

72 FCC 2d 91, 93. GTE had advanced a "contrary position" which relied on a "kind of corporate line drawing" to urge that "the various parents and subsidiaries within the GTE system" be regarded "as completely separate corporations within the meaning of Section 214." Id. at 95-96. Thus GTE submitted that it was not a "carrier" under the section because it "did not provide common carrier services itself but only through separate subsidiaries," and that it was not acquiring Telenet's facilities but only the ownership of the corporation itself" and would "not operate Telenet's facilities because Telenet will remain a separate corporation." Id. at 96. Rejecting these arguments as "overly technical," the Commission countered that:

> As the regulatory agency responsible for the oversight of interstate communications this Commission must be guided by practical considerations and the consequences attendant upon corporate ownership, control, etc. It is not free to "disregard [the] . . . actualities in such intercorporate relations. . .," . . . and to rely instead upon legal fictions.

Id. (Citation omitted). The Commission also observed that "the issues of whether a transaction will entail a change in operation or will result in an impairment of the adequacy or quality of service are issues of fact, appropriately decided by this Commission." Id. at 100-01.

The Section 214 result and reasoning of GTE-Telenet with respect to entry by acquisition may apply with equal force to exit by divestiture. While the proposed consent decree's terminology of "exchange" and "interexchange" is not particularly edifying on the point, it appears clear that the BOC divestiture contemplates severance from AT&T and assumption of control by the BOCs of interstate, as well as intrastate facilities--i.e., "lines" within the meaning of Section 214. It also appears that AT&T may be assuming control of facilities previously operated and controlled by the BOCs. Regardless of the technical corporate stock structuring of the proposed BOC divestiture, we cannot "disregard actualities or rely on legal fictions." Most importantly, Congress did not intend "to limit our jurisdiction over entry or exit of carriers, through acquisition of control or otherwise, in light of its direction to 'regulate[e] interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible. . . a rapid, efficient, Nationwide, and worldwide wire and radio communications service with adequate facilities at reasonable charges.'" 72 FCC 2d at 102.

The Commission's exercise of Section 214 jurisdiction over any BOC divestiture would appear desirable if the Commission is to play its proper regulatory role in approving and supervising the attendant asset valuation and transfer. If the transfer of assets from the BOCs to AT&T's interstate operations is valued too high, the interstate ratepayer will be unfairly burdened. If such transfer is valued too low, the result could have anticompetitive effects for the interstate/interexchange market. The interstate components of a BOC divestiture are uniquely within this agency's primary jurisdiction, and Section 214 conditioning appears to be the most expeditious and effective way of ensuring that this considerable task would be properly executed.*

The Commission's *amicus* memorandum has advised the antitrust suit court that "Under Section 214. . ., the Commission has exclusive authority to authorize the construction and retirement of interstate and foreign communications facilities, and thus effectively controls entry into (and exit from) the market." 62 FCC 2d at 1111. Because "[t]he authority to control entry and exit is crucial to the Commission's mandate to create a communications network," the Commission has further advised the court that "any antitrust remedy which had the effect of subordinating our control. . . to the judicial enforcement of antitrust policy would . . . be contrary to congressional design." *Id.* at 1111-12. I trust, therefore, that the staff will closely examine the possible application of Section 214 to the BOC divestiture issues.

(3) Interconnection Policy

The new consent decree purports to establish requirements, terms, and conditions for BOC interconnection of facilities, services, and equipment with the local exchange and also provides that each BOC is to submit "procedures for ensuring compliance" with the Department of Justice and, by implication, in the event of dispute for review and determination by the court. These provisions in essence would supplant existing Commission rule and policy on interconnection with respect to BOC operations. The decree also contains a provision authorizing a BOC to petition the court for a waiver of the decree's technical standards for equal access with respect to pre-electronic switches upon a showing that such access "is not physically feasible except at costs that clearly outweigh potential benefits to users of telecommunications services."

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* Sections 205 and 220 of the Act provide a possible alternative for asserting FCC jurisdiction over the asset and valuation transfer process.

The Commission's *amicus* memorandum advised the antitrust suit court of its jurisdictional interests in matters of carrier facilities interconnection:

> . . . any case involving interconnection might affect questions of regulatory policy, and we believe, therefore, that the doctrine of primary jurisdiction should apply.
>
> Where the Commission has directed carriers to interconnect their facilities pursuant to Section 201 [of the Communications Act],. . . the antitrust courts may not interfere with that policy judgment by directing otherwise. If the carrier were subject to different masters on such a basic communications policy matter, the Commission's ability to carry out its mandate might be diminished. 62 FCC 2d at 1113.

This Commission has occupied the field of carrier facility interconnection, and I see considerable danger to the effective and consistent implementation of our interconnection policies in allowing the Justice Department and the court to set different standards for interconnection of carrier facilities under the rubric of an antitrust consent decree. In my judgment, our affirmative action is required to ensure that the interconnection of carrier facilities remains under our primary jurisdiction.

As for equipment interconnection, while the Commission's *amicus* memorandum stated that it "has never considered its authority over equipment interconnection to displace the antitrust laws," it also advised the court of "the applicability of primary jurisdiction in cases where antitrust litigation may involve or affect regulatory policy." 62 FCC 2d 114.

The provisions of the consent decree purporting to govern BOC facility and equipment interconnection may be reasonable and appropriate. Moreover, it appears that there is no FCC statutory or regulatory bar against a carrier independently providing "better" interconnection than that presently required by our rules. In my judgment, however, this Commission should assert its primary jurisdiction over these matters and either adopt or reject such provisions according to our own independent policy judgment as to their desirability and efficacy. I believe it would be a serious mistake for this Commission to abdicate its interconnection authority and jurisdiction to the terms of the new consent decree or to "supervision" of the decree by the Justice Department or "interpretation" of the decree by the court.

(4) Tariff Regulation/Access Charges

The new consent decree contains provisions requiring the divested BOCs to provide "exchange access" pursuant to tariff and purports to prescribe the specific terms and conditions for such access to be embodied in the required tariffs. The decree also provides that the required tariffs "shall replace the division of revenues process used to allocate revenues to a BOC for exchange access provided for the interexchange telecommunications of BOCs or AT&T."

These consent decree provisions underscore the FCC jurisdictional concerns previously outlined with respect to interconnection policy, and, further, directly concern this Commission's exclusive jurisdiction with regard to tariff regulation and separations and settlements. As the Commission's amicus memorandum advised the court:

> Congress has entrusted the Commission with the sole authority to prescribe and approve rates, practices, procedures and regulations set forth in tariffs. Even a court with express statutory authority to review agency actions may not prescribe tariff provisions; it may only set aside the Commission's actions as unlawful, unreasonable or arbitrary, and then the Commission must reconsider its action. . . . The Commission must have this exclusive authority if it is to carry out its responsibilities under the [Communications] Act. . . . The Commission alone is empowered and equipped to make judgments of this kind, and its judgments should not be set aside in the context of sporadic antitrust actions.

62 FCC 2d 1115-16 (Citations and footnote omitted). Similar reasoning dictates that this Commission alone, in concert with Joint Board participation of State regulatory authorities, is empowered to prescribe separations and settlements procedures and actions.

While the relevant consent decree provisions may be interpreted as only requiring the divested BOCs to initiate and file conforming exchange access tariffs with the appropriate regulatory authority, the decree cannot thereby dictate the acceptance and approval of such tariffs by the regulatory agency. This Commission must retain its full and independent jurisdictional authority to approve, suspend, investigate, reject, modify or prescribe such tariffs pursuant to Sections 201-205 of the Communications Act. I can also find no authority to support whatsoever for any proposition that the terms of the antitrust consent decree with respect to "exchange access" charges may supercede the interstate/intrastate separations and settlements procedures which this Commission has prescribed in accordance with the Act. While it may be desirable as a matter of communications policy to prescribe a tariff scheme for access charges, and detailed element-by-element cost factors, such action is uniquely entrusted to this Commission's jurisdiction. I believe the FCC's primary jurisdictional interest in each of these matters must be firmly asserted and defended.

(5) Federal-State Jurisdiction

The operative provisions of the new consent decree are structured in primary part according to an "exchange"/"interexchange" distinction. While this distinction is apparently intended to track pending congressional legislation, it appears to bear little resemblance or relationship to the "interstate"/"intrastate" dichotomy that is the jurisdictional cornerstone of the existing Communications Act. Legislation may or may not be soon enacted, and the consent decree's departure from the the jurisdictional terminology of the existing statute and the Commission's mandates thereunder is very troublesome.

In particular, I am concerned that the consent decree, in essence and in effect, purports to "rewrite" the existing Act subject to the interpretation of the Justice Department and the court. I suggest that the staff examine the implications of this observation closely for any such effect would be wholly improper as a matter of law and could put this Commission's statutory mandate in perpetual conflict with the court's administration of the decree.

CONCLUSION

The Commission's amicus memorandum provides an excellent summary of the FCC's proper interests and expectations with respect to judicial review of the new AT&T-DoJ consent decree:

> The Court, we suggest, may not require entry [or, by necessary implication, exit from] the communications market, may not frustrate FCC orders to interconnect telephone systems, and may not base any antitrust relief upon tariff provisions that have been approved or prescribed by the Commission. These matters are implicitly delegated to the Commission's exclusive jurisdiction. As to other specific issues that are within or directly affect the agency's regulatory policies, we believe the Court should refer any unsettled questions to the Commission under the doctrine of primary jurisdiction; where the Commission has settled such questions, the Court should take judicial notice of the Commission's decisions. We urge the court to take no action that will substantially alter the industry structure without initial consideration by the FCC of how such action will comport with the "public interest," as perceived by the Commission in light of its mandate under the Communications Act.

62 FCC 2d at 1119-20.

I repeat--it may well be that the antitrust "settlement" reached by AT&T and DoJ will serve the public interest in telecommunications as well as antitrust policy interests. My comments here should not suggest that I would have the Commission address itself to the new consent decree in other than a spirit of intergovernmental collegiality and respect for the province and authority of the court. I believe we should strive to recognize and accommodate the intentions of the parties under the antitrust law regime consistent with our independent regulatory responsibilities and prerogatives. However, in instances of apparent conflict we should be mindful that our first duty is to preserve the FCC's existing congressional mandate for the formulation and execution of communications policy in the public interest.

In light of the court's stated intent to apply Tunney Act procedures to the new decree, it appears that the Commission will have the opportunity to advise the antitrust decree court of our jurisdictional concerns and policy interests regarding the AT&T-DoJ accord. I am hopeful that the 60-day comment period will provide sufficient time for us to prepare our views and positions with adequate detail and clarity. However, if questions of uncertain resolution arise in our deliberations, we should consider the possibility of requesting that the district court refer such issues to us under the established doctrine of primary jurisdictions. In this regard, it is my understanding that where the regulatory agency has primary jurisdiction with respect to factual and legal questions involved in antitrust proceedings, such referral is customary if not also mandatory. See AT&T v. MCI Communications Corp., 496 F.2d 214 (3d Cir. 1974).

Joseph R. Fogarty
Joseph R. Fogarty
Commissioner

Mr. MARKEY [presiding]. Do any of the other commissioners wish to make opening statements?

All right. In your statement this morning on page 11, you reaffirm the need to implement computer II in order to assure that A.T. & T. services paid for by American ratepayers do not subsidize competitive endeavors. You further state on page 12 that the protections against cross-subsidy of competitive services by the customers of rate-based regulated services should remain at this time.

In the press conference announcing the antitrust settlement, assistant attorney general Baxter suggested that the computer II decision was now quite inappropriate, and that he expected the FCC to take another look at it.

What has led you to believe that computer II is not only still appropriate, but necessary?

Mr. FOWLER. Well, I think the first point would be, as you have suggested and as my statement suggested, we have no present intention as far as I know, speaking for myself and my colleagues, to revisit computer II. One of the primary reasons is simply this: That we do not have a consent decree that has been approved by the court yet. We believe we must continue forward with computer II. I think that the computer II decision and the consent decree are very consistent, one with the other.

They both rely on structural means to promote competition, which we believe to be in the public interest. But I think it is very premature for this agency to even begin to consider revisiting computer II, as long as the consent decree has yet to become a reality.

We have instructed, incidentally, Mr. Markey, our general counsel, and he so filed yesterday, an opposition in the court to a request for a stay of the computer II decision, which had been requested by a party. So at the present time we are continuing forward with computer II.

Mr. **Markey**. Well, is it not the fundamental reason for proceeding with computer II the fact that A.T. & T. still retains a monopoly control of the interexchange market?

Mr. **Fowler**. Well, that is one of the reasons why we have structured computer II as we have. One of the prime reasons for computer II is to permit A.T. & T. to be involved in the new enhanced services and in the CPE markets, which promotes more competition in those markets subject to the structural safeguards that we have included in computer II.

But since they have other bottleneck facilities, that is we have included the safeguard structure in computer II. They still do have those bottleneck facilities. As I said before, the consent decree still has some hurdles to jump.

Mr. **Markey**. In the competitive carrier rulemaking last year, the Commission found that none of the interexchange submarkets, such as MTS, WATS, Private Line, the Public Switch Record, was competitive. In their very excellent review of the antitrust settlement, your common carrier bureau staff recently stated that even after divestiture of the Bell Operating Companies, A.T. & T. still possesses a significant market dominance and ability to engage in anticompetitive behavior on a national scale to warrant continued application of the separate subsidiary requirement.

I assume from your testimony in support of computer II that you still believe this to be the case?

Mr. **Fowler**. Yes.

Mr. **Markey**. You do. One of the conclusions on the part of Mr. Baxter is that they do not have a monopoly in long-distance service. Would you agree or disagree with that?

Mr. **Fowler**. The Assistant Attorney General, I believe drew a distinction between market power and market share. I would say this, Congressman. I think that for our purposes in setting telecommunications policy, it is fair to say that I have seen different figures. The one that seems to be the most authoritative is that A.T. & T. controls 97 percent of the Long Line market together with the Independents.

I think it is fair to say that they do have a virtual monopoly at this time in this market.

Mr. **Markey**. So you would disagree with the conclusion of Mr. Baxter?

Mr. **Fowler**. Well, I do not know whether I agree or disagree because I do not know exactly what he said. But I believe at the present time that we would regard them as still enjoying a monopoly in that market.

Mr. **Markey**. So that would then have some effect upon the need for legislation to insure that you would be able to maintain some regulatory control as to the flow of revenues from the long lines over to the new subsidiary, Western Electric, and their competition in the data processing computer industry?

Mr. **Fowler**. I think we have those tools right now under the 1934 act to do those things and to erect those kinds of structural safeguards.

Let me say this about the market we just referred to, the long lines and long-distance market. As we induce more competition together with the consent decree's provision for equal access to all of the BOCs, competition will thrive and sometime in the foreseeable future we might be able to begin to consider unregulating that market.

But at this time that is not appropriate.

Mr. **Markey**. How does computer II mitigate the admitted long-distance monopoly?

Mr. **Fowler**. Well, it does not mitigate it. But in terms of preventing subsidies flowing from competitive services provided by A.T. & T. or Baby Bell to those services which are a part of the basic nework of A.T. & T. subject to title II regulation, those structural safeguards do protect the ratepayers and also, I think, provide for full, fair and publicly beneficial competition in the new competitive service areas that we have opened up to competition by A.T. & T. through its subsidiary, Baby Bell.

Mr. **Markey**. Mr. Tauzin, do you have any questions?

Mr. **Tauzin**. Yes; thank you.

Mr. Fowler, on page 6 of your statement, sir, you indicate the decree will not necessarily produce any substantial effects on local rates if divestiture is accomplished through a fair implementation plan. Could you highlight for us the problem areas that might inhibit implementation of a fair plan.

Mr. **Fowler**. I would like to preface my response by indicating that we believe the decree will have no immediate effect on local rates simply because it concerns changes in ownership in the industry structure, and does not deal with the allocation of costs and rate making.

There could be some long-term adverse effects if the BOCs are set up so that capital becomes more expensive than is presently the case, which would thereby raise revenue requirements. In other words, through the structure that is set up through the divestiture plan, if the BOCs were undercapitalized or a lot of outmoded equipment was conveyed or kept with the BOCs, this might make the BOCs less attractive to investors wishing to either invest or loan money in the form of loans or debt to the BOCs.

In the case of debt, if the cost of debt is higher, that would necessarily, we believe raise the revenue requirements of those BOCs so affected. And excess costs apportioned to the BOCs during the divestiture, which is really part of that same puzzle, could become part of the local revenue requirement.

The point here is that it is important that the court, the Department of Justice, and this agency scrutinize very carefully the divestiture plan, and in particular the plan of capitalization that would be submitted thereunder by A.T. & T. to prevent those kinds of adverse effects on long-term local rates.

Mr. **Tauzin**. Is that the only potential problem?

Mr. **Fowler**. Apart from the Yellow Pages issue.

Mr. **Tauzin**. Let's talk about that for a second. What is the problem there? How will that effect local rates?

Mr. **Fowler**. I believe the figure I have heard is that Yellow Pages contribute something on the order of $2 billion a year in revenues. The consent decree says the BOC's can provide monopoly services. A.T. & T. provides the competitive services. It is clear that the Yellow Pages have supported local rates.

The consent decree is ambiguous as to where Yellow Pages go. I have heard Chairman Brown suggest that A.T. & T. would retain Yellow Pages, but there would be a phaseout of the revenues given to the BOC's over a 4-year period. For example, the first year the BOC's might enjoy 75 percent of those revenues, the second year 50 percent, the third year 25 percent and in the fourth year a total phaseout.

There may be a compromise position. The rationale would be that the Yellow Pages, are basically advertising and the listings. The listings themselves logically are the property of the BOC's and could be sold either to A.T. & T. or any other company that wanted to publish Yellow Pages in that area.

Each year it seems to me whoever wanted to engage in Yellow Pages publication would necessarily have to obtain that listing from the BOC in order to be able to publish the Yellow Pages. So the compromise might be that the BOC would be able to sell the white page listings to whatever entity wanted to publish the Yellow Pages.

I think this is a matter the Congress might well want to address in any short form legislation. The impact one way or the other on local rates, however, would be rather small.

Mr. TAUZIN. Is the ownership of the Yellow Pages not also a handle on the customers who would eventually purchase equipment for their telephone services? For example, if A.T. & T. continued to own the Yellow Pages, and yearly had to go back to big corporate customers in particular for readvertisements and relistings, does that not give them some sort of real advantage in getting new equipment as opposed to other competitors in the equipment field?

Mr. FOWLER. I do not see the correlation, but maybe I am not getting your point.

Mr. TAUZIN. What other potential problem exists in the consent decree with reference to the fair implementation plan? What about the loss, potential loss of other subsidies to local rates?

Mr. FOWLER. I do not know exactly what you are referring to when you say other subsidies.

Mr. TAUZIN. Well, long line subsidies, for example.

Mr. FOWLER. I do not think that the consent decree is going to have any effect on what we call separations for the reasons I indicated a moment ago. It really does not touch, effect, or concern separations.

The only two areas we see there being any impact on local rates are long term and the ones I just indicated to you which we think can be handled through very careful supervision of the divestiture plan by the courts, by the Department of Justice and by ourselves.

One thing I wanted to say, though, Congressman, is that I do not want to leave the misimpression that local rates would not rise. I think they will rise over a period of years because of other forces that are driving that phenomenon. One, and it is one we are all very familiar with, is inflation. If you have a 10-percent, for example, inflation rate each year for 10 years and you compound it you have a 160-percent increase. So inflation alone is going to, I believe, continue to increase the local rates.

Second, because of increased depreciation rates which have been authorized by our agency in order to track new technologies, equipment is being retired more rapidly, in order to permit the phone companies to recover capital, in order to be able to maintain the system of good service, that will increase the rates. Third, there may be changes in separations. That is, how much of the local exchange costs are picked up by the long distance user. That may change and be lowered because of the competitive aspects of Long Lines competition.

Fourth, expensing of station connctions in effect takes station connections out of the rate base. That may cause an increase in local rates. And ultimately if this commission decides to deregulate inside wiring, if we order that and require the consumer, who wants that inside wiring, to pay what it costs, that too is taken out of the rate base and could cause an increase in local rates.

So there are some other factors that are at work and will be at work irrespective of the consent decree. I think our task there at it has been and our approach has been is to try to avoid any abrupt increases in local rates, try to phase them in responsibly, recognizing that you basically cannot get something for nothing, that someone will have to pay these costs to attempt to alleviate the impact on rural or high cost exchanges through a subsidy mechanism in order to maintain universal service.

Mr. TAUZIN. Is it fair to say then that your belief is that assuming capital costs are not inflated to the BOC's, they have some problem there in improper implementation, and assuming the Yellow Pages issue is resolved fairly, that with or without divestiture, that rates are going to rise under the conditions just outlined?

Mr. FOWLER. Yes, sir, they will rise. But the consent decree itself, as near as we can see, will not have any direct or immediate impact.

Mr. TAUZIN. So it would be the same with or without divestiture?

Mr. FOWLER. Yes, sir.

Mr. TAUZIN. I would love to get the comments perhaps of any other commissioners on the Yellow Pages problem.

Mr. Fogarty, perhaps you could comment for me.

Mr. FOGARTY. Yes, Mr. Congressman. I read in the impact statement submitted by the Justice Department under the Tunney Act procedure that it is the intention of the Justice Department to keep the local operating companies viable.

It very well may be that Justice wants to keep them viable. But the question is yet to be answered, if Yellow Pages revenues are diverted from those operating companies to the A.T. & T. parent company, this obviously is going to require substantial local rate increases to make it up. That is one problem that I have with the impact statement and its impact on local rates.

The second one, is that under the consent decree, as I understand it, access charges, which will be determined by the State and Federal regulatory authorities, are to be cost based. Well, if that is true, and if we are required to adhere to that restriction that they be cost based, then of course, somebody's going to have to make up the difference, because if they are cost based, it seems to me that prohibits any kind of a subsidy decreed by the FCC to flow from long distance, from toll, to the local operating companies.

That will have to be made up somewhere. The only place it can be made up is in the increase of local rates. So it is true as the chairman has pointed out, that the the implementation of FCC competitive policies in and of themselves will force rates up. But I think local rates could be forced up at an even more alarming rate unless something is done to preserve the viability of the local operating companies.

Mr. TAUZIN. Is the problem of cost-basing access charges be an additional concern you think we want to watch out for if we are to keep local rates in line?

Mr. FOGARTY. I think it is imperative that both the Congress and the FCC look very carefully at that requirement of the consent decree—I do not really know what it means. Somebody better explore it.

Mr. EPSTEIN. Commissioner Fogarty raises a question which has occurred to us also. As we interpret the consent decree, that provision for cost-based access charges comes into play after the separations process occurs which we believe, and I think everyone agrees, is not affected by the consent decree. Any kind of social subsidy or other subsidy which the Commission and the States through the joint board decide is in the public interest then would be part of the interstate revenue requirement.

But Commissioner Fogarty does make a point which is not made clearly in either the consent decree or the competitive impact statement. It is that kind of question that we hope could get clarified in the Tunney Act proceeding and in any subsequent conversations we at the Commission have with the Justice Department because it is an important point.

Mr. TAUZIN. Commissioner Fogarty, you are also of the belief that if the revenues from the Yellow Pages are diverted from the local operating companies, that could severely impact local rates?

Mr. FOGARTY. I am convinced of that fact. If you take the $2 billion figure cited by the chairman, that is a substantial amount of money. The Commission, the FCC will be in no position to order that Yellow Pages revenue remain in the local operating companies.

If it is the determination of the Justice Department that it is in the best interest from a competitive standpoint that those revenues come out of the local operating companies, then as far as I can see, the Congress, you are going to have to make the determination whether they remain in the local operating company. I cannot see how those local operating companies can remain viable unless somebody protects their capacity to produce revenue.

Mr. FOWLER. Congressman, I would just like to make one point following up on what I said a while ago.

Mr. TAUZIN. Certainly.

Mr. FOWLER. The white page listings could be sold by the BOC's and they could obtain revenues that way. Point two, it is clearly within Congress' province to order that the Yellow Pages stay with the local BOC's. If the Congress thought that was appropriate policy guidance and thought that was of some value to maintaining the viability of the local BOC's, which is a concern of all of us here, it would seem to make some sense. But we do not take any position on that now.

I would say one thing. That I have seen or heard of one study. It shows that the highest impact, if you totally lost all of the revenues from the Yellow Pages, would be a dollar a year.

Mr. WIRTH. Would you repeat that again for the record, Mr. Fowler?

Mr. FOWLER. Excuse me, a dollar a month. That is in one State, I believe, California.

Mr. WIRTH. Is that the only State?

Mr. FOWLER. I do not want to steal the thunder of other witnesses. I am saying that the $2 billion figure in the scheme of things would not be that significant an increase on local rates.

Mr. WIRTH. Mr. Epstein, do you want to comment from your data on what the impact of Yellow Pages might be on rates in various States across the country?

Mr. EPSTEIN. We could develop for the committee particularized data on a State-by-State basis. I think the point the chairman was making about the fact that the BOC's own the data base which is an integral part of Yellow Pages, is one that should not be overlooked. That is a way of having the local operating companies retain a significant portion of the revenues.

Mr. WIRTH. Let your fingers do the walking through the data base in other words.

Mr. FOGARTY. But you see, Mr. Chairman, if I may, the restrictions that are being placed upon the local operating companies after this divestiture plan is implemented are even more insidious than the obvious ones that we are discussing now, such as the loss of revenues from Yellow Pages.

As I understand the settlement, the local operating companies, Mr. Tauzin, will be prohibited from providing broadband services to the public. In other words, they will be prohibited from providing television broadband services.

Now, the Commission is in the process of making the determination whether we want the local operating companies and the independent telephone companies to be able to provide broadband services.

Now if they cannot provide those services, the local operating companies, they will lose in my estimation a tremendous source of revenue. This is not covered by the settlement as I read it. And it is another area the Congress is going to have to be alert to.

Mr. TAUZIN. So that is a fourth area where the local operating companies can be forced to raise rates for the lack of ability to acquire revenue from other sources.

Mr. FOGARTY. Yes, sir.

Mr. FOWLER. If I might say one thing, as to the Commissioner's point about the restrictions on the BOC's entering other services, I think it is fair to say that I speak on behalf of some, if not all of my colleagues, in noting that we share the concern about that restriction. That ought to be looked at very carefully. There are all kinds of variations, permutations that could be designed.

You could have a sunset provision at a certain date. You could have a certain date when the restriction is reviewed by the court, and then a sunset provision at some time beyond that. I do note that under the consent decree itself, there is a provision whereby the BOC's may petition the court directly at any time to have those restrictions set forth in section II of the consent decree, changed, eliminated, modified.

Mr. TAUZIN. Just through discussing this, we have picked up two more areas of concern. We started with capital cost problems, the Yellow Pages problem and we picked up the cost based access charge problem. And now the limitation on other services problem.

Is there any other problem associated with the consent decree that could impact upon local rates that you can think of today that we ought to be aware of as we proceed through this legislation?

Mr. FOGARTY. You see, you put your finger right on the problem, Mr. Tauzin.

How can any of us intelligently react to this settlement until we see the reorganization plan? How can we comment, even within the 60-day Tunney period, until we see what A.T. & T. proposes to do to meet the requirements of the Antitrust Division?

There may be a myriad of other problems that will arise, other issues, other means by which revenue will be denied to the local operating companies. But nobody will know. We can only guess until we see what that plan is.

Mr. FOWLER. The only thing I would say, Congressman, and I don't necessarily disagree with Commissioner Fogarty, is there might be something at some time that might impact on local rates. But we don't see anything that has to do with the allocation of costs or ratemaking other than what we have mentioned already that could impact on local rates.

So, I think at this time we can reasonably say we don't see that there will be any significant direct impact on local rates.

It is hard to envision that, at least under the consent decree as presently written. It may be obvious to all of us that we will want to wait until we make a final definitive judgment on that. But it is difficult to see that now.

Mr. TAUZIN. Well, we have at least identified four areas where impact could be obtained.

Mr. FOWLER. That is certainly true, sir.

Mr. TAUZIN. If all or any of these four areas are decided incorrectly, your statement that local rates might not be affected by this decision would need amendment.

Mr. FOWLER. I think further to that point and Commissioner Fogarty's point, that is one of the reasons why we want to formalize our relationship with the Department of Justice, so we will have an input on the plan of divestiture. Second, we intend to participate fully and vigorously in the Tunney Act proceedings before Judge Greene. Of course, we have our independent authority under the 1934 Communications Act in granting 214 applications and title III transfers to look at the divestiture plan.

So, we will have three opportunities, we hope, to be able to look very carefully at the divestiture plan and all of the other aspects of it to assure ourselves that we are protected, the ratepayers, to the maximum extent possible.

Mr. TAUZIN. Before I leave it, would any of you care to take another gaze in the crystal ball and tell me if you have any other areas we ought to be looking out for?

Mr. WASHBURN. There is one other possible area, the A.T. & T.'s license contract agreements with the Bell Operating Co. I think that those amount to about 2 percent of gross revenues a year from the BOC's.

Mr. **Tauzin**. Would you describe how that operates?

Mr. **Washburn**. Well, what happens under the reorganization plan depends on whether the local operating companies will be paying more or less for the services which they now get from the parent in accordance with these license contracts.

We really can't tell what the impact will be on local phone rates until the spin-off local phone company gives the figures of what it's going to have to pay for those services when it no longer gets them from A.T. & T. Whether they cost more or less than this 2 percent of revenues, as you say, you need a crystal ball to understand what effect it is going to have on local phone rates.

Mr. **Tauzin**. Current cost is 2 percent?

Mr. **Washburn**. Yes; 2 percent of gross revenues.

Mr. **Tauzin**. You point out to us that we ought to watch, that percentage might not rise in the fallout of the operating agreements?

Mr. **Washburn**. Yes; that is right. It is unknown, really, now, whether the 2 percent is compensatory or not.

Mr. **Tauzin**. Mr. Fowler, what happens to installed telephone equipment under the settlement agreement?

Mr. **Fowler**. The embedded CP that is divested from the BOC's becomes part of A.T. & T.'s activities.

Mr. **Tauzin**. How would you propose deregulating all new equipment under computer II?

Mr. **Fowler**. We are still continuing to do that. We have a bifurcated approach. And we have to very carefully involve ourselves in the implementation proceeding in valuing the equipment before it is transferred. I suppose we would want to dovetail the timetables. I will ask Mr. Epstein, how does that relate to the consent decree?

Mr. **Epstein**. Well, as we view the consent decree, it does not and cannot deregulate customer premises equipment. All that it does is it removes it. The BOC's, after the implementation date, after the 18 months, can no longer provide it. It is still under State tariff regulation.

That is what our computer II implementation proceeding is for. It is to handle, and to handle carefully, the very difficult question of valuation of the embedded customer premises equipment before it becomes deregulated.

Mr. **Tauzin**. I have one final question, Mr. Fowler. You mention on page 9 of your statement that the legislation, legislative revision of common carrier provisions of the Communications Act need no longer concentrate on the difficult issues concerning A.T. & T.'s structural links with its operating companies.

Is it your opinion, then, that Congress should be satisfied and accept those structural links as defined in the consent decree, that we ought not examine them, perhaps move them legislatively in any way?

Mr. **Fowler**. Let me ask Mr. Epstein to answer that one.

Mr. **Epstein**. Yes; Mr. Tauzin, what that particular paragraph focused on was the relationship between A.T. & T. and the operating companies. Part of H.R. 5158 talked about that particular structure. I think all the Chairman was saying in that paragraph was that that issue is basically resolved by the consent decree.

I don't think he was alluding to the point of further or different structural separations with respect to A.T. & T. and other parts of the company.

Mr. TAUZIN. Thank you, Mr. Chairman.

Mr. WIRTH. Thank you, Mr. Tauzin.

First of all, Mr. Epstein, I want to compliment you on the very good work done by the Common Carrier Bureau in looking at the settlement. It is a very thorough and carefully done analytical piece.

Mr. Fowler, you were talking about formalizing the FCC's relationship with the Justice Department and getting involved in the Tunney Act. That was in response to some questions by Mr. Tauzin.

How much time do you have left to do that?

Mr. FOWLER. Well, as to the Department of Justice, we are now attempting to reach some sort of formal relationship which would permit us to have input into the plan of divestiture prior to its being submitted to the court.

Mr. WIRTH. How much time do you have left under the Tunney Act?

Mr. FOWLER. I think the comments have to be filed April 20. Right.

Mr. WIRTH. In terms of commenting under the Tunney Act, you have until April 20?

Mr. FOWLER. That is correct.

Mr. WIRTH. It is now the middle of February?

Mr FOWLER. Yes.

Mr. WIRTH. Have you had any discussions among the members of the Commission about the settlement, focusing on what a Commission position ought to be in terms of your formalized relationship with the Justice Department and your comments to the court under the Tunney Act?

Mr. FOWLER. We have had at least one briefing so far. We will have further briefings on this matter.

Mr. WIRTH. Have you had any discussions on policy direction?

Mr. FOWLER. Yes; we have.

Mr. WIRTH. What form have those taken?

Mr. FOWLER. Well, the first question is, Is it advisable to work with Justice? What can we gain from such a relationship at this time? Is it advisable to formalize that relationship? That is point No. 1.

Point No. 2, should we participate in the Tunney Act proceedings? I think the consensus is, yes, we should. As to the specifics of what we will comment on in the Tunney Act proceeding, we still haven't had enough time to be able to determine our positions.

That will require a lot of consultation among my colleagues before we can reach a decision on that.

Mr. WIRTH. Have you all had discussions——

Mr. FOWLER. Let me also say, Mr. Chairman, we also at the very beginning briefed all of our Commissioners with the briefing book which you are now familiar with on what the impact would be on the various proceedings before the agency, what we believe the consent decree means, ambiguities in the decree, possible problem areas that need refinement, et cetera.

Mr. Wirth. Have you had discussions about what your position will be regarding your relationship with the Justice Department?

Mr. Fowler. I will let them speak for themselves.

Mr. Fogarty. I had, Mr. Chairman, one meeting with Chairman Fowler and the staff of the Common Carrier Bureau to discuss generally what approach the Commission ought to take with regard to a relationship with the Justice Department.

Mr. Wirth. You have had just one briefing?

Mr. Fogarty. One meeting. Actually it was an exchange of ideas between the chairman and myself.

Mr. Wirth. When was the settlement announced?

Mr. Fogarty. January 8. Well, early in January.

Mr. Wirth. What kind of discussions have you had, Mr. Rivera, on the settlement?

Mr. Rivera. I have had some briefings with the Common Carrier Bureau and with the chairman. The Commission as a collegial body has not met and voted on any particular position. I think what the chairman was talking about were these briefings and an attempt by him and the Chief of the Common Carrier Bureau to get the sense of the Commission prior to such a meeting. But there has not been any formal consideration of our position as a collegial body, Mr. Chairman.

Mr. Fowler. That is correct.

Mr. Wirth. This is perhaps the most striking occurrence in the long history of the FCC. This settlement was announced in January. You have until April. I would just urge you to turn up the tempertaure, if you might, Mr. Fowler, in terms of the sense of urgency among the Commissioners if you are going to formalize your relationship with the Justice Department and involve yourself in the Tunney Act.

To use your words, it seems to me you ought to get on with it and get Commissioners discussing and working on this.

Mr. Fowler. Mr. Chairman, I would say the temperature's up right now. There will be further consultations with my colleagues. The study we put together I submit to you, sir, is the most definitive study in Washington on the consent decree.

Mr. Wirth. As I pointed out earlier, it was a good piece of work.

Mr. Fowler. I am just trying to point out we haven't been asleep at the switch, so to speak, either class 4 or 5, and that we are moving forward. It is very complex. It took us by surprise as much as anyone else. It has taken us a good deal of time, a lot of thought and work to get where we are now.

We will be moving faster now and are zeroing in on more of the specifics. We have good discussions so far with the Department of Justice on attempting to formalize the relationship.

I will be briefing my colleagues as soon as we have some definitive things to report on that. We have to also, as you correctly recognize, caucus very soon to determine what our comments might be before Judge Greene.

Mr. Wirth. Let me ask you, Mr. Epstein, just a couple of specific questions about what is in the settlement as you understand it.

You and Mr. Tauzin were talking earlier about cost based access charges. If you have cost based access charges, what does that do to the cost of, lets say, rural Louisiana local phone service?

Mr. EPSTEIN. As I interpret the decree, the separations process is not affected. Subsidies flowing either directly or on an overall basis from the interexchange to the exchange service are still within the province of the joint board and, ultimately, the Commission.

For example, the joint board is now considering a number of plans which would, when and if separations is changed, specifically target high cost and rural exchanges.

Now, it is my view, at least preliminarily, of the settlement agreement, that we would continue to have that power, even if the settlement decree is enacted. That we would still be able to keep in place those kinds of subsidies.

Mr. WIRTH. It is your understanding that the power exists, but it is not clear that it exists?

Mr. EPSTEIN. I would submit it does exist.

Mr. FOWLER. I think it is fairly clear That is our position, sir.

Mr. EPSTEIN. I don't see legally how the consent decree could change separations.

Mr. WIRTH. Reading from page 6 it says:

> Despite the apparent intent of the decree's framers to leave jurisdictional authorities as they found it, the transformation of Bell Operating Companies into connecting carriers under section 2(b)(2) poses certain problems. New theories will have to be developed.
>
> The need to continue to apply these policies is discussed in the case-by-case analysis below, section 4. Our preliminary view is that the Commission will retain this authority as implied power since it is necessary to continue our superintendency of the national phone network.

Should that power be made explicit rather than implied, so that there can be no suggestion that rural phone rates would not continue to receive the historic subsidy that they have?

Mr. EPSTEIN. I have two comments on that. One, as our preliminary analysis works out, we do think the power remains with the Commission. As Chairman Fowler's long-term statement points out, that is one of the things we would like to have clarified, to avoid any potential future litigation.

Mr. WIRTH. I think there are a lot of people up here who are very concerned about the clarification of that. Let me ask you another point. In your discussion with Mr. Tauzin you were talking about what happens to customer premises equipment.

Let me see if I understood what you said. You said that under the consent decree, customer premises equipment is transferred to the parent company; is that right?

Mr. EPSTEIN. Or either to some other subsidiary. It has to be transferred away from the BOC's.

Mr. WIRTH. But it stays in the local rate base?

Mr. EPSTEIN. I think it stays in the local rate base and interstate rate base to the extent it is now. I don't think the consent decree can change that.

Mr. WIRTH. In a regulatory fashion, how does that work? You have the local rate base, which is designed to take care of the local operating company, and you have some equipment in some entity which is not the local operating company. I don't really understand how that would stay in the local rate base.

Mr. EPSTEIN. I think it has to. Both that and interstate toll I don't think can be deregulated by the consent decree. I think it does have to stay under regulation.

Mr. HALPRIN. There is nothing in the decree, Mr. Chairman, that removes it from the State tariffing process. The only thing that would be necessary would be on the one telephone bill there would be an extra line, which some States have adopted anyway. Because it can be collected together there would be a separate line for the——

Mr. WIRTH. Where would this equipment go? You have embedded terminal equipment that has been paid for over a period of time by the local ratepayer. Presumably that gets transferred to some regulated entity in the parent because it has to stay under regulation. Is that right?

Mr. HALPRIN. Yes, sir; under the consent decree.

Mr. WIRTH. So under the consent decree you would have an unregulated Western Electric and an unregulated Bell lab, combined together. Then you would have long distance. Then there would be a third entity that would have control over regulated customer premises equipment?

Mr. HALPRIN. It could be the same entity that provides State toll service.

Mr. WIRTH. So there would be three entities in the parent company, all of which are unrelated one to the other; is that right?

Mr. HALPRIN. Yes, sir.

Mr. WIRTH. Other than the fact they are in that parent company, you would have, under the consent decree, three different entities?

Mr. HALPRIN. Yes, sir.

Mr. EPSTEIN. The way to resolve that, it seems it is in some sense a transitional problem. I think that is what Chairman Fowler meant when he was talking about dovetailing the timing in the consent decree with computer II.

Eventually it is our hope that the embedded equipment under the computer 2 decision would be removed from regulation. That is what our implementation proceeding is all about. With respect to interstate toll, that is something we would hope Congress would address.

Mr. WIRTH. Once the equipment is transferred from the local operating companies to some entity in the parent, it would be the Commission's intent to detariff it; is that right?

Mr. EPSTEIN. That is what our computer II implementation proceeding is about. It is to address how, when, on what terms, and to what extent to deregulate the embedded customer premises equipment.

Mr. WIRTH. Have you made that decision?

Mr. EPSTEIN. No; we haven't. We have a notice.

Mr. WIRTH. Going back to the question Mr. Tauzin was asking earlier, if you were to detariff embedded customer premises equipment, wouldn't that also have an impact on local rates?

Mr. EPSTEIN. That would. That is a policy we had in place long before the consent decree.

Mr. **Wirth**. We are talking about what the variables are. We have talked about access charges, and we have talked about Yellow Pages. Now, doesn't the spectre of detariffing of embedded terminal equipment also have the potential of an impact on the local ratepayer?

Mr. **Epstein**. Yes; the deregulation of terminal equipment, as we have recognized well before the consent decree came down, was a difficult problem——

Mr. **Wirth**. These issues are not new. They are not created by the settlement. They were there and were issues that had to be dealt with in terms of a dramatic increase in rates. All of these questions are now put into starker relief than before.

Mr. **Epstein**. Yes, sir.

Mr. **Wirth**. Perhaps made a little more complicated in terms of jurisdiction. We were talking about the access charges and who has what authority, which has to be clarified. Also, we have the authority to decide what is to be done with embedded terminal equipment, does it stay in the local rate base or does it get transferred, just as with the Yellow Pages. And those three issues ought to be addressed in legislation to make sure they are clarified.

If we wait for a period of time until everything has settled down, isn't the horse out of the barn on all of these issues? I mean, if we wait until all of these court proceedings are finished, this Congress is over, and then we have to start in 1983 again. Then we are into 1984 before there is any legislation, and in the meantime consumers can see their bills going up because of the Yellow Pages issue, the customers premises issue, the access charge issue, the valuation issue; isn't that right?

Mr. **Epstein**. Some of the points you are raising now are points which I think the chairman has advocated going ahead with in the short form bill. That would clarify those issues.

Mr. **Wirth**. All those issues ought to be covered in a bill; is that right?

Mr. **Epstein**. Well, I think we can address them one by one. The section 2(b)(2) issue is one I think the chairman has explicitly supported as being in short form legislation. As far as Yellow Pages, again, I think the Commission would be in favor of resolving that issue.

As far as embedded customer premises equipment, I think that is right now in hand in our implementation proceeding. I think the Commission has made it quite clear that it will take every precaution to minimize whatever effect that will have on local ratepayers.

Mr. **Wirth**. The Commission had also said it wanted to detariff that. Let me ask you another question, if I might, Mr. Fowler.

The separate subsidiary that was created under computer II is, as I understand it, precluded from owning any network or local distribution facilities or equipment. Why is that?

Mr. **Fowler**. Well, the basic concern there was, sir, to make sure that any competitors of Baby Bell, so-called, would have access to the basic backbone network.

Also, it was a means to be able to track any subsidies that might flow between the regulated and unregulated entity using accounting, and using the separate subsidiary as a device to make the accounting more efficacious.

Mr. **Wirth**. In correspondence last summer, the 15th of July, you expressed concern that S. 898 would enable A.T. & T. to transfer transmission facilities to an unregulated separate facility without "consideration of whether the facilities transferred are subject to effective competition."

Under those circumstances, you wrote, the FCC might not be able to "assure the nondiscriminatory availability of adequate transmission capacity for all users and service providers."

You also stated, "Enabling A.T. & T. to provide a currently tariffed service on a deregulated basis as well, even if the service is not subject to effective competition, could have the result of allowing A.T. & T. to transfer its market dominance to the unregulated sector without any determination as to the effect on users or competition."

Has the antitrust settlement agreement of January alleviated any of your concerns in this area?

Mr. **Fowler**. Well, it may well do that, if it is implemented. But I think our position, again, is that we will continue forward with computer II in the meantime. We have no assurance that the consent decree will be ultimately approved. It goes a long way. It uses the same structural safeguards we have advocated except it goes a lot further than computer II did. So to that extent it is very consistent with computer II.

It also would help us from a legal standpoint.

Mr. **Wirth**. There are no longer any concerns?

Mr. **Fowler**. Oh, no.

Mr. **Wirth**. About good transmission?

Mr. **Fowler**. I am saying that, as long as we have the present structure, either we have the kinds of safeguards presented in computer II. If the consent decree, if and when it is ultimately approved and becomes effective, then those concerns can be addressed by the structural changes wrought by the consent degree.

Mr. **Wirth**. I am not quite sure I really understand what your answer is.

Would you like to try again?

Mr. **Halprin**. I can't speak for the commission at all, but I think that the consensus that I have heard from our briefings of the various commissioners is that there is no intent at this time to remove any of the structural conditions as set forth in the computer II decision.

Mr. **Wirth**. So in a noncompetitive long-distance market, you would remain concerned about A.T. & T. being able to duplicate facilities and services on an unregulated basis?

Mr. **Fowler**. That is right.

Mr. **Wirth**. That concern remains and that concern is not addressed in the settlement?

Mr. **Fowler**. No; I think the consent decree would provide a structure that would alleviate those concerns.

Mr. **Wirth**. What structural safeguards does the consent degree provide that are different now than when computer II was written and when you wrote the letter of July 15?

Mr. **Fowler**. I wouldn't say different but I would say consistent with the safeguards.

Mr. **Wirth**. Let me see if I understand. Didn't you just say that things are different now because of the consent degree? I asked you if your concerns were the same now after the settlement as they were before.

Mr. **Fowler**. Well, I am saying——

Mr. **Wirth**. You said no, as I understand it, there were some changes as a result of the consent degree. What were those changes that were made that alleviate your concern about A.T. & T. offering duplicate facilities and services?

Mr. **Fowler**. What I am saying here, sir, is that structural changes that the consent decree would effect would eliminate, I think in large measure, those concerns. Now I want to give——

Mr. **Wirth**. Then what specific elements of the consent decree would alleviate those concerns?

Mr. **Fowler**. I will ask Mr. Epstein to answer that.

Mr. **Epstein**. Access to the local exchange bottleneck becomes less of a problem after the consent decree. But I do not think that the commission has made any determination, at least I haven't heard any that has resolved the issue of whether or not the long-distance interexchange facilities are also a bottleneck, and that computer II structural conditions are not meant to resolve that issue.

In other words, yes, the consent decree has made some changes. To the extent we were relying upon the local exchange bottleneck, we are hopeful that the computer II decree and access to those bottlenecks will go a long way toward promoting competition. The Commission, to my knowledge, has not resolved the issue of whether or not the interexchange market is also in some sense a bottleneck requiring separate structural conditions.

Mr. **Wirth**. So, in other words, what you are saying, Mr. Epstein, is that the concerns related to the competitive nature of the long-distance market, and to the offering of competitive duplicate facilities and services on an unregulated basis, are not addressed in the settlement?

Mr. **Epstein**. You are interpreting what I am saying.

Mr. **Wirth**. I am just trying to get you to speak the King's English.

Mr. **Epstein**. I am trying. I am an engineer and a lawyer and I can't do that, but I do think that the consent decree hs addressed some of the competitive issues. Indeed——

Mr. **Wirth**. How has the consent decree addressed competitive issues in the long-distance area?

Mr. **Epstein**. Not in the long-distance area. I don't think I said it. Let me try it this way. The foundation for the structural foundation requirements, separate facilities requirements in computer II were based upon bottleneck facilities accessed to both the local exchange market and the long-distance market. It so states in our orders.

Mr. **Wirth**. This addresses access to the local exchange, but the competitive nature of the long-distance market has not been changed at all. Is that right?

Mr. **Epstein**. Nicely said.

Mr. **Wirth**. Therefore, your concerns about the offering of unregulated duplicate facilities and services in the long-distance market remain the same as they were before, as reflected in the chairman's letter of July 15?

Mr. **Epstein**. With respect to the long-distance market, I think that is correct. I can't speak for the commissioners.

Mr. **Wirth**. Were the settlement to impact on long-distance competition, which it doesn't, then those concerns could go away. However, anticompetitive concerns remain because the settlement does not impact on the competitive nature of long-distance services.

Mr. **Epstein**. They did in the long term, it may well impact upon long-distance service.

Mr. **Wirth**. That may be true over a long period of time, when we get to the point of it being a competitive marketplace. We have all been through all of this. Is there any disagreement on this?

Mr. **Fowler**. I think the consent decree over the next 2 or 3 years could very quickly have an impact on the competitive nature of the long-distance market.

Mr. **Wirth**. How is that, Mr. Fowler?

Mr. **Fowler**. By making access much more equivalent and fairer for the OCCs competing against A.T. & T. in the long-distance market.

Mr. **Wirth**. I don't think that happens until 1986, so how could it happen in the next 2 or 3 years?

Mr. **Fowler**. OK, 2 or 3 years after that.

Mr. **Wirth**. Mr. Fowler, the proposed modification of the consent decree bars the Bell operating companies from providing any product or service that is not a natural monopoly actually regulated by tariff. We had a very interesting hearing in Iowa last week about this. The operating companies seem to have been placed at a maximum disadvantage as compared to the hundreds of other companies that offer local service today.

You have stated this morning that "The FCC is not convinced that the new local exchange carriers which developed as a result of the decree must forever and in all circumstances be limited to the offering of regulated service."

Your proposed solution is that the consent decree "should either sunset these provisions after a given period of time, or provide the court with a mandate to reexamine at regular times whether the prohibitions on BOC competitive activity in an exchange serice are warranted and to eliminate any restrictions on the BOCs which are no longer justified."

Now, following that statement, do you think that the Congress should take any role in determining the scope of activities permitted for local operating companies?

Mr. **Fowler**. Certainly Congress has that power. Now I don't know whether Congress——

Mr. **Wirth**. So there is no question about that?

Mr. **Fowler**. I don't know whether Congress wants to get into the limitations of the BOCs or not, and that is a decision that only Congress can make. We simply would state, sir, that we have some problems with the limitation on the BOC.

Mr. **Wirth**. What would be your expert advice to us? You have provided that elsewhere in the testimony related to what kind of legislation we should pass. What is your expert advice on the local operating companies on this point?

Mr. **Fowler**. Our advice would be that there ought to be a sunset provision, that on a date certain either that restriction is lifted or on a date the court would evaluate whether that restriction makes any further sense. You could also put the burden the other way. Unless there is some reason why the BOC should continue with that restriction, the court would then eliminate that restriction on a date certain or evaluate the stimulation first and impose then an absolute sunset provision at some time thereafter.

There are lots of combinations. But I guess what we are saying, Mr. Chairman, is that we have some very real problems with that kind of a restriction on the BOCs.

Mr. **Wirth**. We do too. The analogy has been made a number of times in the last 6 weeks to the Bell operating companies, which are crucial links in this communications system "going the way of the railroads." I think that has been the parallel that has been drawn. Perhaps not in the near term, but way down the road, they might be unable or unwilling to raise the capital necessary to keep pace with technological developments.

We could have the situation in which rates would rise, even as the quality of service fell. Continued viability of the operating companies—and this has been expressed by this subcommittee over and over and over again—is essential to the functioning of an integrated national telecommunications network. What would you recommend to us, other than just a sunset provision, in terms of assuring the viability of the local operating company?

Mr. **Fowler**. I think, first of all, Mr. Chairman, we will have to be very careful in evaluating the divestiture plan including the plan of capitalization. That is very critical. That doesn't come before the Congress in and of itself. It is before Judge Greene and we would have to have input with the Department of Justice and under the Tunney Act provisions before Judge Greene.

The Congress in its wisdom might decide it wants to be involved in that area, and certainly the way we view it is that the Department of Justice and the court have their own independent jurisdictions as to the antitrust matters concerned in this case. We have our own independnt jurisdiction as to the telecommunciations issues that are raised by this case, and Congress certainly has independent authority over both areas, and may choose to exercise that authority in one or both.

Mr. **Wirth**. That is ducking the issue, Mr. Fowler.

Mr. **Fowler**. I didn't mean to duck. We are concerned about the restrictions on the BOC's. We would like to have a terminal railroad clause in the consent decree that would recognize our independent jurisdiction so as to eliminate any unnecessary litigation by parties.

I think that the only legislation that we would like to have right now that we think is very important would be a short-form bill. It would provide on a timely basis number one, the ability to forebear from regulating; number two, make competition the purpose of the act; three, make it clear that we do have responsiblities over separations and other matters concerning the local exchanges; and four, make it clear that any access charge filings would be filed with our agency. In that respect, it seems to me to make sense that we would have jurisdiction over intrastate long-distance phone service as your bill H.R. 5158 and S. 898 also provide.

Mr. **Wirth**. When you say we, again in terms of the discussions you have had, is that a position that is taken by all members of the Commission?

Mr. **Fowler**. We haven't formally voted on that. We have discussed——

Mr. **Wirth**. When you say I——

Mr. **Fowler**. I would say at this point I would say I, we haven't caucused on all the specific points.

Mr. **Wirth**. I just wanted to make sure that that is the case.

You wanted to jump in, Mr. Washburn?

Mr. **Washburn**. I think it would be very hard to set a date certain for sunset. I do think it ought to be reviewed at regular intervals, to see whether these restrictions still make any sense. To try to set a date at this point would be very difficult.

Mr. **Wirth**. Therefore?

Mr. **Washburn**. Therefore, if you are going to address legislation to it, I would——

Mr. **Wirth**. What?

Mr. **Washburn**. If you are going to address this in legislation, lifting those restrictions on other possible activities of the local companies, what I am saying is that the legislation should call for review of it at given intervals, to make sure it still make sense; but it should not try to say that at a date certain the restrictions will sunset. Not enough will be known to make realistic the setting of a date. I might be a little different from the chairman on that point. I am not sure.

Mr. **Wirth**. That is the I or we business again, right?

Mr. **Washburn**. Yes.

Mr. **Wirth**. Mr. Markey.

Mr. **Markey**. Thank you, Mr. Chairman.

On the question of patents, and who should be able to benefit from the development of those patents, who should be able to have access to them, many of them now held by Bell Labs, A.T. & T., were funded by the local ratepayers through the license contract, an arrangement under which the operating companies pay a portion of their annual revenues to Bell for research and other services, but not all the fruits of Bell Labs' research efforts have been made available to the ratepayers.

If some of the patent portfolio is used in the development of unregulated products and services, then ratepayers would reap none of the benefits, although they bore all or most of the costs.

As the Common Carrier Bureau's study of the settlement observes, "The local ratepayers who actually finance past license contract payments will be prejudiced if the entiry that furnishes local service is not compensated for the fruits of research that the local ratepayers finance. Some modification of the decree language might be necessary in order to include such compensation in the transaction."

Now, you go on to say in your study that it will be a difficult job. It will be something that is not easily resolved, but it is something that should not be ignored. We get the impression from listening to Mr. Baxter that he is going to ignore it.

What type of action do you plan to try to perhaps in your Tunney Act deliberations, what suggestions do you hope to make to try to deal with this problem?

Mr. **Fowler**. Congressman, we haven't caucused collectively yet to make that determination, so I am speaking only on my own behalf at this point. I think that it is fair to say that in the divestitute plan proceeding, that is where we would be looking at that question it seems to me, and I am not so sure you can sort out what payments were made by various BOCs in subsidizing research of the kind you have alluded to, which furthered patent research and so forth.

I am not so sure we will be able to sort that out. It may be a little bit like trying to sort out a bowl of spaghetti. Maybe the better way to handle it would be to make sure in the plan of capitalization that the BOCs are adequately capitalized.

That is a short answer but for more specifics I would like to ask Mr. Halprin, if he would comment on that.

Mr. **Halprin**. Congressman, the decree is clear that rights to the patents held by Bell Labs and both use of the patents and any rights that are necessary to place them in a viable position are transferred. We at a staff level are continuing to study this area and will do so in particular after we see the plan. We will then make our recommendation to the commission.

Mr. **Markey**. But the ratepayers did buy the plate of spaghetti, did they not?

Mr. **Halprin**. Yes, sir.

Mr. **Markey**. They are just trying to throw a few meatballs on top to confuse us.

Mr. **Fowler**. They told me to be aware of the metaphors before this comittee.

Mr. **Markey**. What about their competitors; what about other people who are in the field who now will have to compete against patents that were developed at ratepayers' expense? What type of access should they have to those patents that were developed in the past and will be developed in the future, some of them by dint of their access to the fees which are generated from the long-distance monopoly service?

Mr. **Halprin**. All existing patents are cross-licensed for the life of the patent. With respect to projects under development, now that is a very difficult area we are studying and we will make a recommendation at the staff level to the commissioners when we see the plan and what provision is made for that area.

Mr. **Markey**. You don't have an opinion right now?

Mr. **Halprin**. No, sir.

Mr. **Markey**. Mr. Fogarty, do you have an opinion on what should happen with those patents past and future?

Mr. **Fogarty**. I have to agree with the staff that the problem is very complex. I don't have the answer, Mr. Markey. Obviously, you have looked at the equities of it. A competitor perhaps ought to have as ready access to the use of the patents, but as far as the compensation, I am not clear myself how that ought to be handled.

It is just another problem that is not resolved in either the impact statement or the proposed settlement that either the FCC or the Congress is going to have to look at to make sure the public interest is protected, because all the Justice Department really is worried about, I think, under the antitrust laws is the promotion of competition. The only other two entities left to look after the ratepayer are you, the Congress, and us, the FCC.

I don't see either one of us being displaced by this agreement of private parties.

Mr. FOWLER. I think, by the way, Congressman, that is something that the entire commission agrees with.

Mr. FOGARTY. But, again, if I may, Mr. Markey, you kow this touting of the sunset provision and some requirement perhaps from the Congress that the court, on a periodic basis, review the implications of the consent decree, neither one of those is going to work, because in the meantime these local operating companies who are restricted principally to just delivering dial tone, the way I read it, are going to be swept away by the competition. They are not even going to be able to get involved in cable ownership.

They will be second-class citizens to the independent telephone companies and to everyone else in the field, so it seems to me to be imperative that the Congress preserve the viability by more than just the statement that Justice has made that they will keep these local operating companies viable.

I think you are going to have to insure that they are viable.

Mr. MARKEY. So the sunset provisions will not be adequate?

Mr. FOGARTY. I think they will be totally inadequate.

Mr. MARKEY. Mr. Quello, how do you feel about that?

Mr. QUELLO. I feel that the sunset provision and periodic reporting may be a very good start.

Mr. MARKEY. It is a good start, but Mr. Fogarty believes that it might be too little too late, that the remedies might be posthumously bestowed upon the victims.

Mr. QUELLO. Yes.

Mr. MARKEY. I was wondering whether or not there might be a way in which legislation or regulation might be imposed to guarantee that they are given access to additional revenue-generating activities that could preserve their viability?

Mr. QUELLO. Until we get to that, I think periodic reports would be very useful, but I would like to know what, specifically, he recommends.

Mr. MARKEY. Mr. Fogarty.

Mr. FOGARTY. I would be very happy to recommend to you. For instance, just take the Yellow Pages and cable telephone cross-ownership. Those ought to be preserved in some part in the local operating companies. Now it is probably not within the power of the Commission to do so, certainly regarding the Yellow Pages we have little if any authority under the Communications Act, and in the cable-telephone cross-ownership field, the consent decree might overcome any decision we may make. So therefore you are the only one left, the Congress.

Mr. MARKEY. What about the customer premises equipment?

Mr. FOGARTY. Customer premises equipment, as the chairman pointed out, is out of the local operating companies within 18 months, but the point is the valuation of that customer premises equipment becomes vital, because if it is transferred out of the local operating companies, as I see it, at too low a cost, it will mean higher local rates.

Mr. **Markey**. It should be transferred out?

Mr. **Fogarty**. That is a question, of course. The Commission has made a determination that we want to deregulate and detariff at least new equipment, and I imagine that will extrapolate and do the same thing to the imbedded equipment. So I think that policy question is probably already decided. However, you could override the Commission with respect to that decision.

But my problem here is with the valuation of that property. The Commission is in no position, absolutely no position at this time to value the imbedded equipment in those local operating companies. If they have to get rid of it at a lower rate than it is worth, then the local ratepayer is going to make up the difference.

Mr. **Markey**. Should the operating companies be able to offer deregulated nontariff, something like GTE?

Mr. **Fogarty**. The local operating companies, it was our determination, should detariff new equipment and it should come out of the rate base. However, this is a different circumstance now. The local operating companies just become 22 new independent telephone companies, so I think they ought to be treated from a competitive standpoint the same as the other independent telephone companies, and if we can't do it, then I suggest you ought to.

Mr. **Markey**. Mr. Washburn.

Mr. **Washburn**. I don't have any further comment on that.

Mr. **Markey**. Mrs. Jones.

Mrs. **Jones**. I tend to agree with Commissioner Fogarty. I really think it is premature for us to be talking about sunset provisions when I really think the thing we should look at first and come to a determination on—and we have not as a commission—is whether indeed all the restrictions on the local operating companies make sense at all.

We seem to be assuming here today that they do, but maybe they won't forever. I think we should look to see if they do at all.

Mr. **Markey**. Are they of any particular concern to you?

Mrs. **Jones**. No, because, frankly, I think part of the problem is it's sort of which comes first, the chicken or egg situation. We are going to be asked to comment in the Tunney proceeding on something that even now we know very little about.

It seems to me vital that there be another comment period available to all interest parties after the reorganization plan is filed by A.T. & T.

I think there are lots of restrictions that perhaps could be removed from all operating companies, depending on how many companies there are ultimately. If there is only one operating company you might be more concerned, but if there are many you would be less concerned. I think we are looking at a very unstructured thing, and I think comment is critical.

I also think there are many undefined phrases in the agreement. There are just so many unthought-through sections and it is a very difficult thing to cope with for that reason.

Mr. **Markey**. Mr. Rivera.

Mr. **Rivera**. I think that what the chairman is attempting to propose by the sunset provisions is some type of a stop-gap measure, without, as Commissioner Jones points out, having the plan in front of us, and having an opportunity to really understand the details of this divestiture. I think it is imperative that we do have a sunset provision.

Mr. **Markey**. Mr. Fogarty, if I could just for 1 second get back to the patents. If I understood you correctly—please clarify this for me—that in terms of the compensation that could be granted for the patents, could be given to the ratepayer in compensation for the development of his patents, that is a question that is very difficult to resolve and needs a lot of study.

On the question of competition, having access to these patents, do you think it is something that clearly should be granted as a part of the development of competition in the telecommunications field; is that correct?

Mr. **Fogarty**. As I think the chief of the bureau pointed out, the cross-licensing provisions perhaps take care of that problem, but certainly, yes, I would agree in principle that there should be open access to utilization of those patents.

Mr. **Markey**. Mr. Chairman, could I ask you, shouldn't the licenses, shouldn't the patents which have already been licensed under the 1956 consent decree continue to be available even if the 1956 decree is superseded by the new settlement?

Mr. **Fowler**. Congressman, I am not prepared to give you a response on that. I would have to study that, frankly, because I could not give you an adequate response. Mr. Halprin may have some staff comments on that.

Mr. **Halprin**. Those are all licensed for the life of the patent. They will continue to exist throughout the entire life of the patent that they are available to everybody who has that, all the competitors.

Mr. **Markey**. Mr. Aylward.

Mr. **Aylward**. As we understand it, there are a number of patents that are licensed for the life of the patent. There are many more licenses which may run for the life of the patent,where the price is subject to renegotiation at regular intervals. Finally, there are a number of patents that are not licensed for the life of the patent. Would anybody who is not now licensed or who would not get a license prior to the time the decree goes into effect be able to get a license to an existing patent?

Mr. **Epstein**. Mr. Aylward, obviously we at staff level have not given the commission a lot of input on the patent question, and if you would like us to follow up with a response to that particular issue, we would be happy to do so. But, quite obviously, from a communications standpoint, we haven't focused on the patent issue specifically.

Mr. **Wirth**. I would like you to get back to us on that. We will leave the record open. How soon do you think you can do that, Mr. Epstein?

Mr. **Epstein**. Mr. Chairman, 10 days.

Mr. **Markey**. A week from Friday?

Mr. **Epstein**. A week from Friday.

Mr. **Markey**. Is that all right, Mr. Fowler?

Mr. **Fowler**. Anything you say, sir.

Mr. **Markey**. Terrific.

We will look forward to it.

Mr. EPSTEIN. We won't be able to comment on the Tunney Act proceeding, however.

Mr. MARKEY. I think would it be very helpful. I think it is very important, as well, if you could, to help to formulate an opinion for us on the terms upon which these patents should be available to competitors, past and future.

Mr. FOWLER. All right, sir.

Mr. MARKEY. I think that would be most helpful to us in trying to formulate that interim legislation, and something I think that is not perhaps contingent upon the final consent decree. It is something that is going to be a problem regardless and doesn't have to wait for any determination by the courts, so it will be important for us in how you see the future of the data processing computer industry developing and who should have access to new ideas, and who should develop it at the ratepayers' expense.

Mr. WIRTH. Mr. Bliley.

Mr. BLILEY. Thank you, Mr. Chairman. I have no questions.

Mr. WIRTH. Mr. Tauzin.

Mr. TAUZIN. Thank you, Mr. Chairman.

In reference to those patents again, have the ratepayers benefitted from those contributions made by the BOCs to Bell Labs over the years?

Mr. HALPRIN. The benefits come in two forms, Congressman. First is that the patents that have been developed are largely patents that have brought the type and quality of service that is now enjoyed by local ratepayers.

Second, under at least some, if not most, of the cross licensing agreements, there are patents that are held by other people which are made available at no additional cost to the Bell System and to those local ratepayers.

Mr. TAUZIN. So that over the years as BOC's have made contributions ratepayers have had the benefits of the new technologies developed not only from the contributions they have made but under the licensing agreement from patents developed by others; is that correct?

Mr. HALPRIN. Yes, sir.

Mr. TAUZIN. What happens with the new settlement now? Will those BOC payments continue to Bell Labs or will they end, cease?

Mr. HALPRIN. There is a requirement that the license contract agreement under which the BOC's provide money to Bell Labs must cease.

Mr. TAUZIN. Must cease?

Mr. HALPRIN. Yes.

Mr. TAUZIN. Is that going to result in any way in lower rates?

Mr. WASHBURN. That is what I was talking about.

Mr. TAUZIN. That is your 2 percent. You just don't know yet? We are going to find out later on when we get the operating agreements all in place.

With reference to the embedded equipment issue, we are talking basically about telephones, are we not?

Mr. FOWLER. Yes.

Mr. TAUZIN. The consent decree places the ownership of that equipment now with A.T. & T.; is that correct?

Mr. **Fowler**. It prohibits the BOCs from engaging in the provision of CPE.

Mr. **Tauzin**. Does it mean that the ownership will be transferred to the parent company in the settlement agreement?

Mr. **Epstein**. As I think I said before—maybe I didn't speak the king's English—I think that under the decree that it is the BOCs which are, after an 18-month period, prohibited from owning the customer premises equipment at that point.

Mr. **Tauzin**. I understand that. Who is going to own it?

Mr. **Epstein**. It could be either A.T. & T. or some other subsidiary of A.T. & T. that is set up, but I think, Mr. Tauzin, you are absolutely correct there has to be some entity under the control of A.T. & T.

Mr. **Tauzin**. Owned by them directly or indirectly?

Mr. **Epstein**. I think so.

Mr. **Tauzin**. So the operating companies are going to lose whatever rental income they derive from the lease of that equipment to customers, the ratepayers; is that correct?

Mr. **Epstein**. The local operating companies would—yes, I believe that is correct. Neither the expenses nor the revenues associated with the customer premises equipment would be the responsibility of or go to the Bell operating companies.

Mr. **Tauzin**. That is right. You lose not only the rentals but also, as you said, the expenses in computing the toll charges; is that correct?

Mr. **Epstein**. I believe so.

Mr. **Tauzin**. So that operating companies, when they are derived from that income and those expensing systems in their rate base, will be faced with, obviously, the necessity of raising other portions of their charges to customers if they can't collect those rentals. Is that correct?

Mr. **Halprin**. Congressman, the point that Gary had made before is that there will be costs that will not have to be covered under the local rates anymore, either. They will not have the benefit of any of the revenues connected with the equipment, but they will not have to cover, under those local rates, any of the costs, either the revenue requirement or the operating expenses connected with it.

Mr. **Tauzin**. I understand. But I would take it then it was a profitable arrangement up until this time, was it not?

Mr. **Halprin**. Yes, sir.

Mr. **Tauzin**. So they are going to lose whatever profit was derived in that arrangement?

Mr. **Halprin**. Congressman, this is a matter which the Commission will be addressing next week, and on which the sunshine notice is out. The Federal-State Joint Board, to which the chairman referred, has recommended to the Commission a plan to insure that the loss of those settlements to which you refer will not take place in an abrupt manner, but neither the staff nor the Commission is free to talk about the merits of that plan at this point.

Mr. **Tauzin**. Whether it is abrupt or whether it is spread out over some time, it means higher costs to ratepayers in the long run, or in the short run if it is abrupt, does it not?

Mr. HALPRIN. Yes, sir, that is a consequence of the deregulation of the equipment that has been referred to here.

Mr. TAUZIN. Now once you move the equipment out of the BOC's and into the ownership of A.T. & T. or its subsidiary structure, does it really matter to the ratepayer in regard to the BOC, at least whether you detariff or not? What is the effect of detariffing at that point?

Mr. HALPRIN. Congressman, you are correct. At the point at which the ownership of the CPE is in a different entity from the entity that provides basic dial tone local service, there no longer can be a settlement contribution to it, and so once the separation takes place, the issue is not as important to the local ratepayer.

Mr. TAUZIN. To whom will the local ratepayer pay rentals on that equipment?

Mr. HALPRIN. So long as it is offered under tariff, he will be able to pay on the basis of a single bill, but those revenues would go to A.T. & T. while it is offered under tariff.

Mr. TAUZIN. When it is detariffed, how will that arrangement be changed if in fact you detariffed?

Mr. HALPRIN. Congressman, that is a matter on which there is a great deal of activity at the State level. A variety of States have currently ongoing proceedings that are looking towards the sale of the used embedded residential equipment to those customers, and neither the consent decree nor any actions by the Commission foreclose that possibility. The answer is that we don't know, and that actions that the States take will have a major effect, a major impact on that answer.

Mr. TAUZIN. So what you are saying, in effect, is that much as I would rent a car and have a lease purchase term, there could be arrangements whereby through State action customers might be able to, at the end of their lease, in effect, purchase the equipment for some cost yet to be determined in these proceedings. Is that correct?

Mr. HALPRIN. Yes, sir.

Mr. TAUZIN. And of course the determination of which way that issue goes could also impact upon customer cost for service?

Mr. HALPRIN. Yes, sir.

Mr. TAUZIN. Thank you, Mr. Chairman.

Mr. MARKEY. Mr. Chairman, could I just follow-up on one more point, just so I am clear in the requests that I am making to the Commission on their opinions on who should have access to these patents? Not only am I concerned with the patents which have developed in the past, and are now licensed or not licensed, but also future patents which will be developed or are being developed, for example, the 5-year program which has been underway to develop a machine that can answer information calls by computer, and I would like to have the Commission's comments on whether or not they believe competitors should have access to this concept, and how the ratepayers should be compensated if it is developed, and to what extent. Thank you.

Mr. WIRTH. Thank you all very much for coming. There are a great number of issues we are faced with that have come up this morning. I think that you are expressing the same concerns that many members of the subcommittee have had. As I get from you the need for legislation, I would like to list those issues that, as my notes show, have come up this morning. I think all of these are touched upon by Mr. Epstein's excellent document, which I would commend to all of you for a very careful perusal. Again, I think it is a first-rate piece of work.

To summarize the issues we have dealt with this morning: The authority not to regulate, which you talked about in your testimony, Mr. Fowler; the jurisdiction over access charges which came up, Mr. Epstein, in our exchange; the yellow pages issue, which has come up in this hearing and in a number of previous hearings; the customer premises equipment issue, which has consumed a good deal of time this morning; the patent issue; the duplicate long distance facilities and equipment issues; other issues related to development of full and fair competition; and the viability of the Bell operating companies.

As you pointed out, Mr. Fowler, they are not new issues, and as we have said on a number of occasions, these are issues that have to be addressed legislatively by the Congress.

One final note before you all leave and we hear from Mr. Wunder. As you know, this morning's hearing was on common carrier legislation, but it is imperative that I comment on the Commission's unequivocal violation of Federal law in refusing last week to adopt a lottery procedure for low-power television, though that was clearly spelled out and required by an act of Congress passed last year.

I might remind you again that the FCC is a creature of the Congress, and if Congress orders the FCC to do something, you must do it. Apparently Commissioner Fogarty is the only one of you who understands that clear principle under which the Commission must operate, and under which the Congress operates, which is laid out very clearly in the Constitution of the United States.

All I have to say is that as chairman of this subcommittee, I want that act rectified very soon. I leave you with that word, Mr. Fowler and Commissioners. Mr. Fogarty, I want to commend you for your appropriate reading of the Constitution and of the role of the FCC.

Mr. FOGARTY. Thank you.

Mr. WIRTH. Thank you very much.

Mr. FOWLER. Congressman, I just want to respond to that point. With all due respect, sir, I think that what we did——

Mr. WIRTH. This is not, I might point out, Mr. Fowler, a hearing on anything other than H.R. 5158 and the settlement. This is a hearing on the common carrier——

Mr. FOWLER. I would think you would want to hear our position on that.

Mr. WIRTH. I wanted to make it very clear what the requirements of the legislation are, and I thank you all very much for being with us.

Mr. FOWLER. I am sorry you feel that way. Thank you, Mr. Chairman.

Mr. WIRTH. The subcommittee will come to order.

Our next witness is no stranger to the subcommittee, the Assistant Secretary of Commerce, the Honorable Bernard J. Wunder.

Bernie, welcome back to the subcommittee. We are delighted to have you here today, and look forward to receiving your testimony. I think that we have all had a chance to review your testimony. I would hope you might be able to summarize your testimony and then we could get into a discussion with you about it. Thank you.

STATEMENT OF BERNARD J. WUNDER, JR., ASSISTANT SECRETARY OF COMMERCE, DEPARTMENT OF COMMERCE

Mr. **Wunder**. Thank you, Mr. Chairman. I had intended to summarize my testimony. I have just a few points that I want to make.

My testimony doesn't sound very much like me. It sounds like it was written by a committee.

Let me explain where we are as an administration. I think that we have arrived at a———

Mr. **Wirth**. Would you speak into the microphone and start again. I just want to hear that statement made again.

Mr. **Wunder**. We think we have a very good settlement from the antitrust point of view. This does not mean the settlement solves all telecommunications policy issues. We have indicated in the past, and we still believe that Congress should settle telecommunications policy.

What should be done now, however, on the A.T. & T. structures issues, is to wait for resolution of the court proceedings on the proposed settlement. It seems to me that we are in this situation.

You could draft legislation and craft it around the terms of the existing decree—the existing decree, or the proposed decree which may not be the one that goes into effect or it may not go into effect at all.

On the other hand, you could go forward with legislation that was inconsistent with the decree, have the decree go into effect and the proposed decree when it went into effect could unilaterally amend the legislation, which it would seem to me would require additional legislation.

What we think now is the course to proceed on is to deal with a number of issues that are unrelated to the decree. Some of those areas I have identified in my testimony—access charges, national security, emergency preparedness, regulatory forebearance, regulatory jurisdiction. It wouldn't seem to me an exclusive list.

I think that there are other things that clearly would fall within the type of policy that we have adopted; for instance, depreciation, interconnection for non-A.T. & T. telephone companies, tariff reform, employee protection. So what I am specifically referring to, then, is sections like section 243 dealing with procurement, 251 on the consent decree, 252 and 253 with respect to the subsidiaries, 263 and 275 dealing with the treatment of the dominant carrier during the transition.

When the settlement then is acted upon and the decree goes into effect, or the decree doesn't go into effect, it would be appropriate for the Congress, with respect to the A.T. & T. structure issues, to look at what the decree provides, assuming it goes into effect, and take a look at the telecommunications policy issues that then exist.

Just to summarize, we could clearly support legislation that dealt with the areas that fall outside the areas covered by the proposed consent decree. Thank you, Mr. Chairman.

Mr. WIRTH. Thank you, Mr. Wunder. Your statement will be included in full in the record.

[Mr. Wunder's prepared statement follows:]

Statement of

Bernard J. Wunder, Jr.
Assistant Secretary for Communications and Information
U. S. Department of Commerce

Thank you for inviting me to discuss briefly H.R. 5158, the common carrier communications legislation that the Subcommittee is considering, as well as some of the important regulatory reform issues that are raised by this bill and recent industry developments, namely, the proposed settlement of the Justice Department's AT&T antitrust case.

The Reagan Administration's position in this area is straightforward, and let me state it succinctly and directly. We believe that comprehensive legislation, such as H.R. 5158 or the companion Senate bill, S. 898, should not be enacted pending the completion of the court proceedings surrounding the proposed settlement that are now underway. The Administration, in short, feels strongly that the most prudent course of action for Congress at this time is to wait until the dust settles, as I indicated in my statement before the Senate Commerce Committee on January 25.

We could support narrowly focused, "target efficient" legislation addressing certain key communications policy issues which will remain significant, independent of the settlement process, however. If Congress is committed to passing a common carrier bill this Session, therefore, we believe that it should focus on the following matters.

The first area where I believe Congress can prudently act -- and while the settlement process goes forward -- concerns what I called in my recent Senate statement the area of rate stability. Although, as I testified before the Senate Commerce Committee, the proposed settlement of the AT&T case will not produce substantial local rate increases in and of itself, these rates could go up in the absence of any positive action by the States and the Federal Communications Commission (FCC).

The FCC and State commissioners have regulatory powers sufficient to prevent unreasonable increases in local charges. If Congress, nevertheless, is concerned that Federal and State regulators lack authority or will not take steps to ensure that local telephone rates do not increase unreasonably, it can mandate the establishment of an access charges system to resolve the problem. There are relevant provisions in S. 898 and H.R. 5158. We are fully prepared to work affirmatively with the Subcommittee in this area, in developing a mutually satisfactory system.

Second, the Administration continues strongly to support the prompt passage of sound provisions addressing national defense, security, and emergency preparedness concerns, along the lines of those that are now contained in S. 898. Legislation requiring regulators and industry to take full account of important national defense and emergency preparedness requirements was needed before the announcement of the proposed settlement, and we believe that this plain need will be even greater following the divestiture of AT&T's local telephone exchange operations.

Third, we believe that legislation addressing troublesome, regulatory jurisdictional problems may be in order. I believe, for example, that there is a consensus that regulatory jurisdiction over long-distance, toll services should now be centralized under the Federal Communications Commission's auspices. The relevant technology and industry marketing practices should no longer be constrained by artificial regulatory boundaries. Vesting full authority over long-distance services in the FCC, in our view, would promote greater competition and foster economic efficiency while, at the same time, reduce the often duplicative and wasteful tariff filing requirements the current regulatory system imposes on carriers.

Fourth, the Administration strongly believes that the FCC now should be accorded an explicit statutory mandate to eliminate economic regulation where it is not needed. At present, the Commission's authority to forbear from regulating in the common carrier communications field remains unresolved. The problem, moreover, is not that the FCC will necessarily seek to impose or perpetuate outmoded regulation on the industry involuntarily. Rather, the problem is that as communications markets become more competitive -- in part because of the proposed settlement -- the industry players may seek the comfortable protection of "pervasive regulation." Congress thus may appropriately want to act now both to forestall the growth of needless regulation, as well as to accomplish the deregulation of services that are effectively competitive.

While the Administration thus could support focused legislation dealing with these four key communications policy matters, we do not support legislation dealing with the following topics.

To begin with, we are opposed to any legislation seeking to further restructure AT&T at this time. The district court is currently reviewing the adequacy of the proposed settlement in light of the competitive problems that were alleged in the Government's complaint. The provisions of S. 898 calling for the "unbundling" of Western Electric's production, for instance, were premised, however, on the assumption that the parent firm would continue to be engaged in all parts of the telecommunications services business. Under the proposed decree, of course, AT&T will be obliged to divest its local telephone exchange "bottleneck" facilities. The firm will also no longer enjoy its alleged "captive market" with respect to, particularly, "big ticket" telecommunications equipment, such as switches. The Administration thus believes that Congress should not undertake legislatively to mandate a further restructuring of AT&T, and especially not while the court proceedings are going forward and a full record concerning the results of the proposed divestiture has yet to be established.

Secondly, we do not believe that Congress should pass legislation aimed at curtailing or preventing AT&T's participation in the so-called "information services" field. These, for the most part, are new services, and there's no record of any competitive abuses. Most people agree that these new services, if they develop competitively, could yield important public dividends, and offer consumers broader choices.

Past restrictions on AT&T that some have proposed, of course, were again predicated on the firm's control of local telephone exchange facilities, and the contention that this control could be exercised unlawfully to restrain full and fair competition in this new, rapidly developing field. The proposed settlement, however, removes this "bottleneck" issue from serious consideration.

Third, the Administration would oppose legislation dealing with the restrictions that are on the new service offerings of the divested local exchange companies, or interfering with those restrictions now contained in the proposed decree. The local exchange companies, under the proposed decree, will be limited to providing exchange telecommunications and access services , or services that are "natural monopoly" services actually regulated by tariff. We do not believe that further statutory restrictions on the activities of the local exchange companies are necessary or in order.

Perhaps the chief issue affecting the domestic telecommunications industry, and certainly the principal focus of the past six years of Congressional and regulatory study and debate, has been the structure of AT&T. The proposed settlement of the Justice Department's antitrust case basically resolves these past structural issues. The settlement does not -- and should not be expected to -- resolve many of the other important questions with which this Subcommittee and others have grappled, questions dealing with: (1) rate stability and access charges issues; (2) national defense, security, and emergency preparedness concerns; (3) jurisdictional questions; and (4) regulatory forbearance. The Administration is prepared to support narrowly focused legislation addressing each of these four key areas.

We believe, in conclusion, that other proposals for comprehensive legislation that have been advanced warrant further, careful study. Hence we would not support and, indeed would strongly oppose, legislation dealing with: (1) further AT&T restructuring; (2) restricting AT&T's legitimate participation in the emerging "information services" field; (3) the diversification of the divested local exchange companies; or (4) legislation proposing changes that conflict with the terms of the proposed settlement.

That concludes my prepared statement, Mr. Chairman. Let me close by assuring you that NTIA continues to stand ready to assist the Subcommittee in its further consideration of legislation dealing effectively with the four key policy areas that I have outlined. If we can provide you with additional technical assistance or information on these matters, we would be pleased to do so.

Mr. **Wirth**. Let me see if I understand what you just said. You are basically in agreement with everything in the draft legislation here with the exception of the A.T. & T. structure issue. Is that right?

Mr. **Wunder**. With respect to the ability to deal with those issues, I won't say I would agree with the terms of the specific section. But dealing with the areas that are outside the structure issue, we think that those are areas that the Congress could very well legislate on without any adverse effect on the decree. It would be the prudent course to do just that, to deal with those types of issues that can be dealt with now, but are not affected or would not impact upon the decree, and leave the questions of the A.T. & T. structure until after we see what happens with the proposed settlement.

For instance, I am sure we could not support your public participation provisions. We can put these nonstructure issues in two categories, but clearly that would seem to me to be an appropriate area for the Congress to address It would not impact upon the decree.

Mr. **Wirth**. Let me, if I might, Mr. Wunder, take it from the top, regarding the legislative mandate and the position of the administration, the Commerce Department and the Cabinet Council. You remember that last spring Secretary Baldrige chaired the Cabinet Council Task Force on Telecommunications Policy, and that task force recommended that the Justice Department's antitrust suit against A.T. & T. be dismissed. We are going back to that point.

The task force had reached that conclusion in large measure because it felt, to quote from the task force, "the issues to be resolved in connection with revising the Communications Act of 1934 were such as are best handled in a legislative forum."

This was the Cabinet Council. In an interview with the Washington Star last August, the late Washington Star, Secretary Baldrige was even more direct. "Communications policy," Secretary Baldrige said, "is too important for the courts because it affects everyone in the United States. It should be decided by the branch of Government closest to the people, after full and fair hearings."

Your written testimony this morning would appear to be a significant departure from what Mr. Baldridge said, but I think that your verbal comments now seem to be not quite as firm a statement. Your written statement, in effect, says wait until the dust settles in Judge Greene's courtroom before going ahead, and you are now saying something more consistent with what Secretary Baldrige was saying last year.

Mr. **Wunder**. That is one of the reasons, quite frankly, Mr. Chairman, that I went into in oral testimony, primarily because our view is that telecommunications policy, quite apart from antitrust actions that are the subject of court action, should be dealt with by the Congress.

Mr. **Wirth**. Let me then go to the antitrust questions. You will recall that the task force report last spring also considered the possibility that the antitrust suit could be settled by a consent decree. However, the task force found that even under those circumstances, the Tunney Act proceedings, like those recently initiated by Judge Greene, would "make it impossible to conclude the litigation in any reasonable time."

The task force also concluded that "action in a judicial forum would not be ended for years. The need for publication and comment on any proposed consent decree, and more important, the possibility of intervention by parties, make final resolution of the case in less than a period of years after a consent decree is filed an impossibility."

Yet we are still hearing, despite what the task force said last spring, that comprehensive legislation, by your written statement this morning, "should not be enacted pending the completion of the court proceedings which are now underway," which is effectively saying let's wait for a number of years.

Is there some way of resolving those two statements?

Mr. WUNDER. Sure; at the time that that document from which you are reading was written, quite frankly, never in my wildest dreams did I ever think that A.T. & T. was going to accept a settlement that looks like the one they have. I thought it was going to be some sort of hybrid settlement that looked like some of the settlement proposals that have been disclosed in the proceedings to date and that are disclosed in that document.

There would not be wholesale divestiture of the operating companies. The intervention would be much more significant and much more significant issues would be raised as a result of that intervention than I think exists now with respect to the decree that we have. So I think that from that perspective, we see now the process of the settlement taking a much shorter period of time than we envisaged at the time. Second, that was one of our primary goals, as evidenced in that document, that we wanted to achieve certainty, and achieve certainty over a relatively short period of time.

Mr. WIRTH. In other words, you think that because of this settlement, that there won't be any litigation, that it won't drag on in this fashion?

Mr. WUNDER. I don't think it will drag on as long.

Mr. WIRTH. On what basis do you make that judgment? What kind of a settlement did you expect before that?

Mr. WUNDER. I expected a settlement, for instance like the settlement that they talked about in the beginning of last year, where several of the operating companies were to be divested, and portions of Western Electric were to be divested, and with some injunctive relief with respect to, for instance, inter connection.

That was the type of settlement that I thought——

Mr. WIRTH. That kind of a modest settlement would gin up more litigation than this——

Mr. WUNDER. I think so, that would be my judgment.

Mr. WIRTH. The task force report also talked about a number of costs of continuing the A.T. & T. antitrust litigation, and the attendant uncertainty in the communications industry. The task force referred to these costs as including the increased costs of capital for A.T. & T., potential stagnation of local telephone service, and issues relating to international trade and national defense.

Will these costs, do you think, continue under the settlement, or wouldn't there be any costs now?

Mr. WUNDER. Of the costs that you cite with respect to A.T. & T. I think that they will go away. I think that what we were saying there very clearly was that if this thing dragged on for so long, that the type of costs that we identified would continue to accrue, and it was costly to continue. I think that that document was written in June, as I recall, and 7 months later the case was settled.

Mr. WIRTH. There is something I don't understand. The discussion came up earlier with the FCC, about the issues we are dealing with. Did you hear the discussion?

Mr. WUNDER. Yes.

Mr. WIRTH. It was pointed out that these are not issues that are new because of the settlement. They were all there before and they are still there now.

Mr. WUNDER. Right; I agree.

Mr. WIRTH. Now if the administration felt that legislation was necessary before to address those issues, why isn't it necessary for those issues to be addressed by legislation now, if in fact the issues aren't new? They were there before, and they are there today.

Mr. WUNDER. I think that is what I have said. Act with respect to those issues, access charges, regulatory forebearance, interconnection for non-A.T. & T. telephone companies.

Mr. WIRTH. What about some of the other issues that were brought up this morning, like customer premises equipment?

Mr. WUNDER. Customer premises equipment, I believe, Mr. Chairman, could be dealt with either legislatively or by regulatory action.

Mr. WIRTH. If one were concerned about keeping it in the local rate base, that would be done legislatively, right?

Mr. WUNDER. I believe you could do it also in a regulatory sense.

Mr. WIRTH. Who would do that?

Mr. WUNDER. State regulatory commissions, staying in the rate base.

Mr. WIRTH. Doesn't the settlement say that the transfer is to the parent company?

Mr. WUNDER. No; it has to be transferred out of the BOC.

Mr. WIRTH. It gets transferred out of the BOC's. It no longer stays with the local operating company.

Mr. WUNDER. I think one of the things that is actively being considered now is for, for instance, Southern Bell and Mountain States Bell to stay in existence, and a new company would be formed that would be the BOC, and that company would still be under the jurisdiction of the State PUC, No. 1.

No. 2, I think that you could develop a regulatory scenario where the revenues—ownership may be transferred, but the revenues—could continue from that embedded plant that you are concerned about, treating it as if it were still owned.

Mr. WIRTH. But the FCC has told us this morning that they would, consistent with what they have done in the past, detariff that, so it would then be lost to the local operating companies or to the revenue base.

Mr. WUNDER. Sure.

Mr. WIRTH. So the revenues would be lost to the local customer, right?

Mr. **Wunder**. Sure, but here is the way they are approaching it, it seems to me. They are going to detariff new equipment, and then treat on a phased basis the embedded plant in a way that I believe would be similar to the approach that you have taken in your legislation. When the equipment is depreciated, then it goes to the other side.

Mr. **Wirth**. They could do that?

Mr. **Wunder**. I think so.

Mr. **Wirth**. Do you believe that it is a good idea to do it that way?

Mr. **Wunder**. It certainly is one way to avoid an adverse impact upon local rates.

Mr. **Wirth**. Would you recommend that it be done that way, or haven't you taken any position on that?

Mr. **Wunder**. We haven't taken a position on that. Let me stop there, because in the considerations on S. 898, the administration did take a position in favor of the phase-out of embedded plant. That was the type of approach that you just talked about as one that we thought was a viable approach.

Mr. **Wirth**. Just one last structural question, if I might, Mr. Wunder. A couple of weeks ago Mr. Baxter testified before a joint hearing of the Commerce Committee and the Judiciary Committee, and at that point he said that until the interexchange market became competitive, there was a danger that A.T. & T.'s long-distance revenues could cross-subsidize Bell's offerings of other products and services. He suggested that the Congress might want to take action to prevent this cross-subsidy.

Is that a structural question?

Mr. **Wunder**. It seems to me that that is a structural question, Mr. Chairman.

Mr. **Wirth**. Mr. Baxter was suggesting maybe we should do that. You would suggest that that is outside of the kinds of things that we ought to be looking at.

Mr. **Wunder**. Yes, sir, I do.

Mr. **Wirth**. Do you see any danger of cross-subsidy between the regulated long distance in the parent company and the unregulated Western Electric in the parent company?

Mr. **Wunder**. My response to that would be twofold. One, it seems to me under the new structural scheme that accounting procedures could be put into place to deal with the types of concerns——

Mr. **Wirth**. We went through all of that 2 years ago, on whether cross-subsidies could be prevented by accounting procedures. I think it was everybody's agreement that we have a horse-in-the-barn syndrome and accounting is not the way you go about preventing cross-subsidies. Isn't that correct, in the history of all of the discussions of the cross——

Mr. **Wunder**. You are partially correct.

Mr. **Wirth**. I think you were involved in that.

Mr. **Wunder**. You are partially correct. What was relied upon was a combination of accounting-structural provisions. By virtue of the divestiture of the operating companies, it seems to me that that job is now considerably easier.

Mr. WIRTH. What does that have to do with the parent, with the relationship between regulated long distance and unregulated Western Electric within the parent?

Mr. WUNDER. The accounting job was much bigger then, obviously, when we went to the structural approach. The accounting job was much bigger.

Mr. WIRTH. It was much tougher?

Mr. WUNDER. That is correct.

Mr. WIRTH. What you are suggesting is that accounting, protection was tougher when you had an integrated system with the Bell operating companies involved. Now that you have had divestiture of the local operating companies, accounting is better to solve the problem of potential cross-subsidies between long distance and equipment. Is that correct?

Mr. WUNDER. Coupled with the fact that it seems to me that if long-distance revenues are going to be retained at their existing level, or increased for the purpose of cross-subsidy, it would be a self-defeating business policy on A.T. & T.'s part, given the fact that we have either actual or potential competition coming into the market.

Bear in mind that one of the reasons why an MCI exists was because of Bell's high rates. It would come in, and offer a competitive service at a lower rate. It seems to me if A.T. & T. wanted to encourage that, then what they should do to encourage even more competition by their own action would be to raise their rates, keep them high for the purpose of cross-subsidy, and they would get a lot more competitors in their long-distance business. It seems to me that is a self-defeating corporate policy on their part.

Mr. WIRTH. Was that not the same concern we had 2 years ago, that that would be a self-defeating corporate policy? Why did we spend so much time on the cross-subsidy issue and come to agreement that it was a significant issue? Why would it not be just as self-defeating 2 years ago as it is today?

Mr. WUNDER. We were looking also then at the real possibility of cross-subsidy from what is close now to a natural monopoly.

Mr. WIRTH. A.T. & T. now has a monopoly in local exchange operations and effectively 97 percent of the long-distance traffic. What is the difference? It is a difference in scale perhaps, but not a difference in concept.

Mr. WUNDER. I think it is. I think you do not see much competition for local exchange today. The difference in concept is that you do see people offering competitive long-distance service, with the potential for more. There is a possibility of competition in the local exchange, but it is nowhere near us in this timeframe.

With new technology, with cellular radio and things like that, there may come to pass the opportunity for active competition in local exchange. That does not face us today.

Mr. WIRTH. Mr. Markey.

Mr. MARKEY. Is Long Lines a monopoly or not?

Mr. WUNDER. Is Long Lines a monopoly?

Mr. MARKEY. Yes.

Mr. WUNDER. If you look at the antitrust literature, and some of the cases, they place less and less importance on market share. It seems to me the old rules with respect to market share are no longer applicable.

Mr. Markey. We have only had two people in here, you and Charlie Brown, so far, that——

Mr. Wunder. I have not said yet my complete answer. What I would say at this time is that they have a market share of monopoly proportions.

Mr. Markey. They have a market share of monopoly proportions. So they have a monopoly.

Mr. Wunder. It is not a natural monopoly.

Mr. Markey. It is not a natural monopoly? Under the classic definition of monopoly I thought that it was that someone could raise their rates substantially without having it make a major impact on their total share of the market. Last year they raised it 16 percent, and there really was not any substantial effect on the overall market share.

It seems to me that, if that is going to be the test, then you would be hard pressed to say that, and you said earlier that the reason that MCI is able to continue to stay viable is that A.T. & T. charges higher rates. Now how in the world can they charge higher rates and not have a monopoly, and still be able to compete with their competitors unless their competitors are not real competitors in the classic sense of the word.

Just help to reconcile that for us.

Mr. Wunder. One, I think that MCI, and especially SBS, are in fact real competitors of A.T. & T. I especially look at SBS. No. 2, I saw you ask the same question of Mr. Brown. I think the jury is probably still out on whether the increases in rates that you cite have had impact upon A.T. & T.'s business. I saw what Mr. Brown said, that it did in fact cause them to, his company, to lose some business.

Mr. Markey. Their revenues last year went up $3 billion. I think that there is a real problem with that. We also had testimony, people, users, equipment manufacturers, long-distance competitors, Wall Street analysts, even just ordinary consumers and consumer advocates who have been in here testifying before the subcommittee in the past month or so who all have testified at substantial variance to the conclusion that you have come to on the——

Mr. Wunder. Which conclusion?

Mr. Markey. The question of the long distance monopoly, the effect that it has.

Mr. Wunder. I read all that testimony myself. I would not think what I said would be in conflict with the testimony I saw.

Mr. Markey. The conclusions you have come to as a result of your analysis are, though. The question is whether or not any additional structural protection is needed for competitors to A.T. & T. as a result of the fact that they have, by dint of their market share control, a de facto monopoly at this time. Mr. Baxter talked about a transition period of protection, 4 or 5 years, being built in. He asked us if we would run it by him, what possible remedies we would suggest.

But they did not discount the necessity of providing that structural remedy.

Mr. **Wunder**. Nor do I. All I am saying is, it would not seem to me to be prudent to do it now. I do not want to craft a piece of legislation around the consent decree, or proposed consent decree which may not come into being. With respect to the transition-type mechanism that Mr. Baxter is talking about, that would be the type of area that, I indicated in my opening remarks, would be appropriate for the Congress to look at after they have the full details on what the A.T. & T. structure will look like once the settlement is accepted.

Mr. **Markey**. Let us just deal with it theoretically then. Let us just talk in terms of the Long Lines being part of an entity with the Bell Labs and Western Electric. The labs and Western Electric are providing services to long lines in the development of new products, marketing, manufacturing of them.

Mr. **Wunder**. Right.

Mr. **Markey**. But at the same time, they are being able to develop product for Western Electric in their unregulated activities now.

Mr. **Wunder**. Right.

Mr. **Markey**. Would it make any sense for us in that kind of a situation to insure that there is complete structural separation between Long Lines and Bell Labs and Western Electric to protect the competitors from that kind of anticompetitive activity?

Mr. **Wunder**. This is a permanent——

Mr. **Markey**. That is right.

Mr. **Wunder**. As opposed to the transition-type thing.

Mr. **Markey**. Let us just say for the transition period, 4 or 5 years.

Mr. **Wunder**. I would agree with Mr. Baxter, that that is something that it would be appropriate to look at. In terms of whether or not something like that should be permanent, if the settlement works as it is intended to work, the problems you identify it seems, would be greatly ameliorated. We have eliminated a lot of the barriers as a result of this settlement.

The primary barrier, it seems to me, to competition is the question of access, equal access. We have named the other problem, the capital market.

Mr. **Markey**. We are not talking permanent, now. We are just talking the interim, because we know that, despite the fact that in the year 2000, there may indeed be real competition in long distance, it is very capital intensive, facilities are not readily available, it is not going to be something that is easily overcome.

Regulatory barriers are still uncertain as this legislation is formulated and how it will be finally drafted. There is still a lot of unanswered questions. It will be a long transition period. We have had studies from A.T. & T. that indicate that even after 10 more years of competition, they still expect to have an 85 percent share of the market.

The question is what do we do in the interim, though, while there still is a monopoly of a captive market here. Do we build in those kinds of structural protections? What do you think?

Mr. **Wunder**. Quite frankly, I would be willing to take a look at the transition-type approach, as Mr. Baxter would. But it seems to me that, for the reasons that I stated, where you and I disagree is on the significance of the problem.

I think for the reasons I indicated, the elimination of barriers, accelerated competition coming into place, we have actual and potential competition right now. For A.T. & T. to deliberately hold up their rates, charge higher rates for the purpose of cross-subsidy, would be a self-defeating corporate policy.

That would have been easy enough to do, and that was the reason for the settlement being structured the way it is. They could do that with the local exchange, because they would fear no loss of business by holding up those rates, or increasing those rates. That is why the BOC's were divested.

Mr. **Markey**. Let us talk about the transition period. Smaller computer, data processing companies out there right now in the marketplace developed over the last 25 years in the aftermath of the 1956 consent decree, they now face the prospects of having to compete against the company that, by dint of their, let us say, transition period monopoly, waiting for potential competition to become competition from additional entrants into the market or increase in market share by those already in the market, are being able, as Long Lines, to be able to take the monopoly rate revenues and helping to subsidize Western Electric in their near term competition with these smaller companies that are out there right now helping to—underpricing their product in the near term in order to get a larger share of that computer and data processing market.

Now, at the point, let us just say this theoretically could happen, at the point at which competition becomes more intense, in long distance, they can then bring their prices down there in order to meet that price competition.

Mr. **Wunder**. They have already brought competition into the market as a result of the high rates.

Mr. **Markey**. But by that time they have already got, let us say, 20 percent of the data processing and computer market.

Mr. **Wunder**. How did we arrive at that.

Mr. **Markey**. I am just saying, they go in with a vengence, trying to get a big chunk of this very lucrative industry. They do so by using the help of their long lines revenues. They are willing to accept a certain amount of loss of business in long lines so they can establish themselves over here in the data processing and computer industry.

After establishing themselves over here, getting a reasonably large chunk of that business, they then can go back over to the long lines. If they feel the loss of business is too great over there, an the computer and data processing industry is well established, that wing of their business, they can then lower their rates in long lines and now have a self-sustaining computer wing.

Mr. **Wunder**. Right.

Mr. **Markey**. Is that a theory that makes any sense to you?

Mr. **Wunder**. That is an interesting theory. It seems to me that A.T. & T., going into the computer business; I mean I look at the example of Exxon, with a lot of money, going into the terminal equipment business. They have not bowled anybody over. You know——

Mr. **Markey**. I think if A.T. & T. went into the oil business, they probably would not bowl anybody over. But this is A.T. & T. entering the computer and telecommunications business.

Mr. **Wunder**. I understand. But this would be a new business for them. It would be a new business venture. Second, for the reasons that I cited, it would not seem to me that, if I were at A.T. & T., I would not keep my rates up since that would bring in actual price competitors. I would not want another SBS backed by IBM in the marketplace, or somebody backed by Exxon.

Mr. **Markey**. You are saying, maybe you would not. But that does not mean that they would not. That does not mean that your business judgment and theirs is identical.

Mr. **Wunder**. Well, that is probably——

Mr. **Markey**. Yes, there is a big problem. Your ideas and theirs might be totally different when they see a lucrative market in the future.

Since they have had a history in the past 10 years of being able to have their rate increases rubberstamped by the FCC, and still having 97 percent of the market, they might be willing to insure that kind of shrinkage, that percentage loss over the next decade, if they felt it might be helpful to them in carving out a larger chunk of the computer and data processing business and sharpening up both 10 years down the line with the appropriate business decisions.

Mr. **Wunder**. First, let me say I think what we are probably going to have to do here is agree to disagree. I see A.T. & T.'s business to be continuing as the telephone business. I think that will continue to be the bedrock of their business, plus their telecommunications equipment sales. I really do not see the magnitude of the problem that you see, although, clearly——

Mr. **Markey**. Do you see a problem in the interim? Do you see a problem with some of these smaller companies that might get hurt if there is not really any structural protection against cross-subsidization, waiting for real competition to develop?

Mr. **Wunder**. I think that is probably the case where A.T. & T. is the weakest, in the short term is in the types of businesses you cite. They are getting into new business, they are having the start-up problems anybody getting into new business has. It seems to me if I were they, I would be worried about a big competitor, longer down the road, considerably longer down the road.

Mr. **Markey**. So you are telling us, and Mr. Baxter did not say this, he actually said the contrary, that in the short term he could envision small companies being swept out as A.T. & T. went in and targeted specific markets or areas of interest to them in the short term.

You do not agree with that analysis by him?

Mr. **Wunder**. No; I do not.

Mr. **Markey**. You do not. Just so we understand completely the administration's policy, you do not think that any structural protection whatsoever is needed in order to protect competitors against cross-subsidization from long lines?

Mr. **Wunder**. What we have said is that——

Mr. **Markey**. You are saying in the short term they would not need protection; in the long term, because they will be stronger than A.T. & T., in the long term they would not need any protection because they will be able to, you know, make the adjustments that are necessary to, you know, compete in the marketplace; is that correct?

Mr. **Wunder**. That is right.

Mr. **Markey**. So you do not think there is any structural changes needed whatsoever?

Mr. **Wunder**. Structural changes to deal——

Mr. **Markey**. With the questions of cross-subsidy.

Mr. **Wunder**. From Long Lines?

Mr. **Markey**. That is right.

Mr. **Wunder**. No; I do not.

Mr. **Markey**. You do not?

Mr. **Wunder**. I do not.

Mr. **Markey**. So how do we protect against cross-subsidization?

Mr. **Wunder**. For the reasons I cited, I think the marketplace protects against the cross-subsidization. First of all, these are still going to be regulated entities. Nobody is deregulated. Nobody is deregulated, Long Lines, or A.T. & T. private line, or A.T. & T.-MTS and A.T. & T.-WATS. You could impose accounting procedures to deal with that question, as I indicated to the Chairman.

Second, I just do not see the problem as aggravated as you see it.

Mr. **Markey**. Of course, we are 5 years away from having a new reformed uniform system of accounts put in place that may more accurately be able to——

Mr. **Wunder**. I do not know why that has to be the case, why 5 years is necessary. It seems to me that the reason why the Commission has had trouble with coming up with a system of accounts is the question of costing methodology. What we considered in the legislation in 1980, as you recall, was a simpler approach to the accounting problem. The testimony before this committee in 1980 was that that type of accounting could come about in about 6 months.

Mr. **Markey**. I will believe it when I see it.

Thank you, Mr. Chairman.

Mr. **Tauzin** [presiding]. The gentleman from Virginia, Mr. Bliley.

Mr. **Bliley**. Thank you, Mr. Chairman.

Thank you, Mr. Wunder, for joining us today. I have particular difficulty with your position that we should wait for the settlement to be completed before doing any legislation. As one who has long been in favor of judicial restraint, I hesitate to leave setting national policy up to one man, answerable to no one, for practical purposes. Especially since, as far as I see it, one of the prime reasons for the existence of this body is to set national policy.

Certainly one of the chief reasons for the existence of this committee and subcommittee is to regulate interstate commerce. And you can hardly get more involved in interstate commerce than A. T. & T. is today.

You have stated that the Administration would oppose legislation dealing with restrictions on the operating companies. Yet, right before you the FCC says we should address this issue. How can we ignore the threat of huge local rate increases and potentially unprofitable operating companies? Are these not important telecommunications policy issues?

Suppose, for example, we do not do legislation, we take your position. There is no guarantee that the judge is going to modify the settlement. He just may have to, in a period of time, just say fine;

sign an order, and that is the end of it. And then we have got to start scrambling from scratch to try to come up with a bill.

Do you not think it would be helpful to the court, maybe, if we spoke?

Mr. WUNDER. Mr. Bliley, that is not my testimony. What I have indicated is that only those areas dealing with A.T. & T. structure should be held in abeyance. On the question of local rates that you identify, specifically included in my testimony is a statement with respect to the access charge mechanism.

What I am saying to you is this: You have a proposed settlement pending before the court. It either is going to be approved or disapproved sometime later this year. Now, how are you going to write legislation? Are you going to craft that legislation around the decree, and assume the decree is going to be exactly as it is currently written?

Mr. BLILEY. I think obviously we will take the decree into consideration. But certainly there is no compunction on this committee to say that it is going to be accepted or not be accepted. It is our job to set policy. From where I sit, we should proceed on that basis.

Mr. WUNDER. I am not quarreling with that.

Mr. BLILEY. I do not see how, you cannot just say structure, and local operating companies and complete separation. Whatever we do is going to affect both, and whatever we do not do will affect both.

Mr. WUNDER. I would disagree with that, Mr. Bliley. I think you could clearly enact legislation in the areas that I have identified that would have no impact at all on the decree.

Mr. BLILEY. Would you say yellow pages would have an impact on the decree, if we determine in our wisdom, or lack of it, that it should go to the local operating companies?

Mr. WUNDER. That would have an effect on the decree, yes, it would.

Mr. BLILEY. But is that not a local rate issue?

Mr. WUNDER. Yes; but what I am suggesting to you is that there can be a developed alternative through an access mechanism, a surcharge.

Mr. BLILEY. Surcharge to what?

Mr. WUNDER. To local exchange facilities.

Mr. BLILEY. How would local exchange facilities be involved with yellow pages?

Mr. WUNDER. What I am saying is, just as we did with the legislation that passed this committee in 1980, if you want, you can make up all of that lost revenue, or any lost revenue with a surcharge on the access charge. That was one of the purposes of the third account of the NTP in H.R. 6121.

Mr. BLILEY. For the purpose of argument, you can go up on the access charge. But you have finite limits, because the big users can always go to direct satellite broadcasts and set their own dish up on their roof. Each of their subsidiaries around the country have it, and thereby avoid the system and compound what we are already in. Part of the reason for this settlement and divestiture was the fact that that was happening. So the access charge is not a cure-all because there are finite limits as to how far you can go in that direction, unless you want to disregard the fact that big users have the potential capability of escaping.

Mr. WUNDER. They have that today, Mr. Bliley, No. 1. No. 2, the question of where to set the access charge, and where to set the surcharge has always been a balancing process for the reasons that you cite. We have done some preliminary studies on rate increases. It is not totally complete. But I do have a couple pages here that are done.

If there were no change in SPF, no CPE regulation, no expensing of inside wiring, no implementation of depreciation changes, and a continuation of yellow pages in the rate base, by 1986, you would have to have roughly a 33-percent increase in rates, going up on the Bell System average from $9 to $12.

Using another scenario, where you assume a frozen SPF, CDE coming out of the rate base, phased-in expensing of inside wiring, implementation of the depreciation changes that the Commission is promulgating, and elimination of the yellow pages, you are talking about a rate increase of not from $9 to $12, but $9 to $15.

Mr. BLILEY. What does that break out in percentage?

Mr. TAUZIN. Double.

Mr. WUNDER. Sixty eight percent. Not double. $9 to $15 is 68 percent.

Mr. TAUZIN. Doubles the percentage increase.

Mr. WUNDER. That is right.

Mr. BLILEY. Thank you, Mr. Chairman.

Mr. TAUZIN. Mr. Rinaldo, questions?

Mr. RINALDO. Thank you, Mr. Chairman.

First of all, I want to welcome Mr. Wunder to this hearing. He is certainly no stranger to this committee.

It is nice to have you here and I guess after listening to all the questions that maybe you sometimes wish you were back on this side of the table.

Mr. WUNDER. It's easier.

Mr. RINALDO. It's easier preparing the questions than answering them.

Mr. WUNDER. That's right.

Mr. RINALDO. I have just two questions. I am concerned, first of all, about the thousands of A.T. & T. employees who are going to be affected by the divestiture of the local telephone company. Many of them presumably will be transferred to new companies within the A.T. & T. organization. Many others will be transferred from A.T. & T. to the divested companies, and I am concerned that the rights of the employees be protected.

When I speak about rights, I am talking about existing benefits, wages, and collective-bargaining rights. Would the administration be in favor of the inclusion of provisions in the House bill that protect the rights of employees whose jobs are affected by the divestiture of the local telephone operations?

Mr. WUNDER. I don't think we have a problem with that all. I think, however, with respect to that particular issue, it seems to me that that is another structural issue. It seems to me, you ought to await the outcome and get more details on what exactly is occurring, and what exactly is happening or going to happen with respect to those employees.

I think, as a general proposition, that it wouldn't seem to me that we would have a problem with that at all. They were in the Senate bill.

Mr. **Rinaldo**. They were in the Senate bill.

Mr. **Wunder**. And we supported the Senate bill.

Mr. **Rinaldo**. There were substantially the same provisions in the House bill.

Mr. **Wunder**. That is right. I think they are almost exactly the same.

Mr. **Rinaldo**. We heard some talk about local telephone rates, and of course that concerns all of us. It is very important to people who represent districts where there are many low to moderate income people who require a telephone, and who are having a difficult time making ends meet. Now, H.R. 5158 requires A.T. & T. affiliates to purchase increasing specified amounts of telecommunications equipment from manufacturers who are unaffiliated with A.T. & T. The FCC is required to enforce this requirement.

Now, as I understand it, in the bill quotas are established, and the local company has to buy a certain percentage or a certain quota from a manufacturer other than A.T. & T. My concern is that by establishing these quotas, we could inadvertently be causing rates to rise because the local operating companies would not always be in a position of purchasing the least expensive equipment. They would have to satisfy the quota first.

I am going to ask two questions. First of all, do you agree that, though this is a well-intentioned section, it could create problems by adversely affecting the consumer and, second, does the administration support outside procurement quotas? If so, why, or why not?

Mr. **Wunder**. With respect to the first question, I think the answer is "yes," if there were not an exception in there, that they could get a waiver from the procurement requirements.

On the second point, with respect to procurement, we supported the other procurement amendment to S. 898. That was in the presettlement era.

If the settlement goes into effect, the necessity for a procurement requirement has been eliminated, because the captive market has been eliminated. In terms of why we supported it then, as opposed to now: It was for exactly the reasons the Bell operating companies were divested—so as to give access to others, especially our domestic industry, to the Bell System market. What we were seeking to accomplish was to develop and enhance the competitive market for equipment manufacturing in the United States.

Mr. **Rinaldo**. In other words, right now you are saying you wouldn't support it. Let's say the bill passed in its present form. I mentioned some of my fears about quotas, that they may lead in effect to uneconomic purchases. More importantly, I think a quota requirement would place a very extraordinary enforcement responsibility on the FCC. It would be required, first of all, to establish categories.

It would be required to set up a mechanism for A.T. & T. affiliates and divested companies to report their equipment purchases, in each equipment category, to the Commission. It would have to establish criteria for granting waivers from the outside procurement standards, and so forth. You could go on and on.

Do you think you or the FCC has the capacity to do that fairly, and do you think—and this is the nub of the question that really has not yet been answered—that if the bill passes with that provision in it, that the effect, the final effect down the road, could be higher local rates?

Mr. **Wunder**. In terms of capacity, I think the answer is yes. In terms of could it have the possibility for higher rates, I think the answer to that question is yes too, if there were not a provision in there saying that they could get it now if they had to buy higher equipment to meet their quota requirement.

I think the problem, though, that you identify, Mr. Rinaldo, is one of the reasons why the settlement was done the way it was done. It produces much less regulation of the types of things that you are referring to than does, say, the procurement provisions.

The FCC won't have to go through this separating-out the categories and keeping records of how many percentages in what product lines A.T. & T. is selling and buying, or the BOC's. So what the settlement has done, it seems to me, is accomplished the same goal. You have opened up the captive market, and you have required the BOC's to purchase on a nondiscriminatory basis.

It seems to me that if that settlement is approved and those aspects stay in place, the necessity for procurement amendments no longer exists.

Mr. **Rinaldo**. I think you have answered the question sufficiently. Thank you very much. I have no further questions.

Mr. **Tauzin**. Thank you, Mr. Rinaldo.

Mr. Wunder, the Commission has earlier identified actually six areas for me where the consumer charges might be affected as a consequence of the settlement agreement. One was in the question of how you capitalize the BOC's, the second was in the fact that yellow pages and the revenues from yellow pages were being moved over to A.T. & T., the third was the access charges which you focused on; the next was the prohibition of the BOC's from engaging in broad-based services, the next was the licensing agreements; and the last was the fact of the local imbedded equipment would be either owned or controlled by A.T. & T., and that revenues, profits from that operation would be lost to the operating companies.

It also occurs to me that until there is an actual divestiture, that there is nobody speaking for the BOC's, because they don't really exist as separate entities today, and so that it is really incumbent upon those in the administration and those of us in the Congress and the FCC and the local utility regulators to be very concerned about that area, because it impacts on those folks we all serve.

Mr. **Wunder**. I agree.

Mr. **Tauzin**. When I looked at all the possible effects on consumer increases and looked at your statement, I noticed that you discounted all of them. You say we ought not deal with any of them other than access charges. We ought not deal with the restrictions on the services offered by the BOC's, as contained in the settlement agreement.

Neither should we change or get into the structural arrangements by which yellow pages and the local equipment would belong either to A.T. & T. or to another subsidiary of A.T. & T., and that income would be lost to the operating companies. Neither should we deal in the basic question of the structural relationships between A.T. & T., the parent, and the operating companies.

You have left only the option of dealing with access charges. Mr. Bliley got into that just a bit. I would like to explore that just a bit more with you.

Mr. Bliley mentioned that there is some ceiling, some limit as to how far you can go on access charges. We had a discussion earlier that the settlement agreement requires access charges to be cost based. I took that to mean that you had to set them on the basis of cost, and I was told, no, you could do it at 1.5 of cost, et cetera.

Mr. WUNDER. Mr. Tauzin, if you look——

Mr. TAUZIN. Let me finish the question because it is a long one.

Mr. WUNDER. I am sorry.

Mr. TAUZIN. When you get to that point, now, recognizing that you can't place access charges at unreasonable limits, after all, as Mr. Bliley pointed out, large customers are going to avoid access charges.

In fact, the largest customer, A.T. & T., has the greatest ability to avoid those access charges, by going directly by satellite or by some other land-based equipment to the larger customers, the more profitable customers of the operating companies, to avoid any access charges, so that increasing access charges to extract from A.T. & T. income for the BOC's that it otherwise lost to them in this settlement agreement in my view is not a very viable option.

Could you describe to me why you think it is?

WUNDER. Yes; the issue is this. You cite a number of points, but the root cause is really all one issue as to the viability of the operating companies. Let me take some of these one at a time.

On the question that Joe Fogarty mentioned, eliminating cable telephone cross-ownership S.980 prohibited that.

Mr. TAUZIN. It prohibited it for A.T. & T.

Mr. WUNDER. The operating companies, and the problem——

Mr. TAUZIN. Well, there was only one company called A.T. & T.

Mr. WUNDER. The problem addressed is the same problem: The ownership of the local loop, and the Senate voted this. I really don't see legislation passing letting the Bell operating companies divested or not get in the cable business.

Mr. TAUZIN. Your point is that the other competitors in that area would have the same objection to the BOCs engaging in that as they would to A.T. & T. as a single entity?

Mr. WUNDER. Absolutely. In terms of embedded equipment, as I indicated in my response to the chairman, it seems to me there are regulatory mechanisms that can deal with that. In terms of capitalization: capitalization is just another way of saying—what it costs them for capital is just another way of saying, are they viable? If they are viable, they won't have higher capital costs. If they are not viable, they will. So the question really is as to the question of viability of the operating companies.

What I am suggesting to you, based on the numbers that I have looked at so far, is that the access charge would not have to be very significantly above cost to compensate for the totality of the loss.

Take a look at the House bill, H.R. 5158. It would cap SPF. It has a phase-out on CPE regulation, does not implement depreciation and continuation in the yellow pages. Even with all those things going out of the rate base, you are looking at a 68-percent increase.

Mr. **Tauzin**. The big users are already avoiding access charges, on the assumption that they were being overcharged. How can you argue going up on access charges now that A.T. & T., recognizing that A.T. & T. has the capacity to avoid those access charges better than anybody else, is presently avoiding them?

Mr. **Wunder**. Let me put it this way. You are exactly right in terms of access charges staying low. If we allowed SPF to continue at the rate it was going up, that would produce exactly the result that you describe, because people will avoid access. They will go to alternative carriers because the price is too high.

That is why the Commission is moving to cap SPF. That is why SPF is in your bill, and what we are dealing with is occurring not insignificantly now. The question is the future trend, if it stays that high. So what I am suggesting to you is that you can balance that by keeping a reasonable access charge, not having significant rate increases, and deal with the competitive situation. That has entirely been the thrust of the legislative effort in committee since it began.

Mr. **Tauzin**. You can't go up on access charges. You have got to keep them reasonable in order to help the BOC's remain viable, and they have only two other choices. That is, to seek legislative, administrative help in recouping some of the income they lost, potentially lost in this settlement, or going to the ratepayers. You are suggesting to us that we let them go to the ratepayers?

Mr. **Wunder**. No; rates are going to go up irrespective.

Mr. **Tauzin**. They are going to go up, but not as much as you predict they will if we let the BOCs go to the ratepayers for a settlement.

Mr. **Wunder**. I am almost assuming a worst case scenario.

Mr. **Tauzin**. But your worst case scenario doubles the increase to ratepayers.

Mr. **Wunder**. But do you see, for instance—I don't—CPE totally, coming out of the rate base? I see regulatory mechanisms addressing that, and the question becomes not whether rates will go up but whether they will go up, and in what degree.

Mr. **Tauzin**. I don't argue that. That is what we are debating here, as to whether we ought to set up a scenario and not redress it here that will prevent it from going up to a degree double what it would go up as you predicted without the settlement agreement. That concerns ratepayers around the country.

Are we going to sit by and allow a scenario to develop that gives the BOC's no other option to remain viable but to ask for double the rate increases they would ordinarily ask for over the next 9 years?

Mr. **Wunder**. $12 to $15. $12 as opposed to $15, not double what they pay.

Mr. **Tauzin**. Double the rate of increases.

Mr. WUNDER. That is correct.

Mr. TAUZIN. That would ordinarily be required to pay.

Mr. WUNDER. You are talking about the Bell System now, remember, and let me tell you there are a lot of phone companies in this country that are charging in excess of $15 for rates right now.

Mr. TAUZIN. They are companies that are not in competition with Bell, because Bell is not there. They are local independent phone companies.

Mr. WUNDER. That is right.

Mr. TAUZIN. Servicing areas which have a high cost for service.

Mr. WUNDER. Or they are servicing suburban areas which are also high cost.

Mr. TAUZIN. But you would not recommend for us that we, for example, deal with the yellow pages issue at all?

Mr. WUNDER. In terms of the yellow pages issue, it seems to me that that is not as significant an issue as it is being made out to be. I look at John Bryson's letter to Lionel Van Deerlin in 1980, and he indicated that what you are talking about is a dollar in rate increases, which could be made up, as Mr. Baxter testified, by the sale of the listings, which I think, as he indicated, is a valuable commodity.

You could offer it for sale and make money, so you have substantially, it seems to me, mitigated the effect of the loss of the yellow pages revenue. Look at what we are doing here. What we are saying is that an unregulated activity should cross-subsidize a regulated activity. It seemed to me that what we are trying to get away from is cross-subsidies.

Mr. TAUZIN. That is one certainly laudable goal, but in doing so, if you derive the regulated activity sources of income upon which it depended, such as profit from the rental of its equipment, and such as sales of Yellow Pages advertisements, which are not through subsidies, simply income from activities which you are going to deprive them of, you further restrict them for purposes of protecting other competitors in broad-based activities so they can't have income there. You almost certainly require them to ask more of their ratepayers for the services they are presently getting, and you limit their ability to earn income in other areas.

That is what concerns me and the ratepayers, I think, of the Nation in the settlement agreement. What concerns me about your position is you are saying we ought not be focusing on that. We ought to just be worried about access charges.

Mr. WUNDER. I never said that. I think what you are describing, Mr. Tauzin, is the problems caused by competition, because what is driving local rates up is that local rates are going to move towards cost. They are currently priced at below cost, because they are being subsidized. That is why there is a move to cap SPF that A.T. & T. supports. The ones that don't support it are the small telephone companies. They are not facing competition.

Mr. TAUZIN. We are not talking about competition.

Mr. WUNDER. I think we are.

Mr. TAUZIN. We are talking about regulated rates. We are talking about rates set by some commission charged to ratepayers, and if they have been held low for the purpose of universal service of the country, and that goal is indeed a laudable goal, they have been held low because there were other activities conducted which were profitable, which could help in effect keep the rates low.

Now what is occurring, as I view it, is that in the separation of A.T. & T. and its subsidiaries, that some of those activities which were profitable to the BOC's and could be profitable to the BOC's to help keep rates low are going to be deprived of them in the settlement agreement, and that they are going to have to in fact raise rates.

I don't see any way around that if in fact you take away their capacity to earn money from other sources other than ratepayers.

Mr. WUNDER. Mr. Tauzin, let me get back to this point, because I should explain to you that local rates are going up because we are moving to cost-based pricing, because A.T. & T. is now in competition for long-distance service. They cannot continue to subsidize local telephone companies at the rate that they have been subsidizing them and compete over the long haul. The reason why we are taking terminal equipment out of the rate base is because terminal equipment is a competitive industry.

In your bill, new terminal equipment doesn't go into the rate base. You could include it in the rate base if you wanted to, but we are moving towards a competitive environment. They are not going to be able to earn money under anybody's scenario, legislative or regulatory, on the new terminal equipment.

Now if you want them to earn money on the new terminal equipment, and you want the subsidies to continue, what you do is you say there will be no competition.

Mr. TAUZIN. You are saying you can't earn money in a competitive field?

Mr. WUNDER. I am saying you can earn money in a competitive field so long as you don't have to subsidize a noncompetitive field.

Mr. TAUZIN. The chief counsel, Mr. Aylward, has a question.

Mr. AYLWARD. Mr. Wunder, I don't think anybody disagrees with that. The question is only how fast the competition is coming in and therefore how fast one makes the transition to it. I think everybody assumes that in the long run that the competition in terminal equipment will cause the price of terminal equipment to go down.

Mr. WUNDER. Sure.

Mr. AYLWARD. Long term it will cause the price of long distance to go down and the quality go up so the local rates will probably go up.

Mr. WUNDER. Yes.

Mr. AYLWARD. The question is whether we are going to make all those pricing changes in the next 2 or 3 years or whether we are going to make them over the next 10 or 15. I have two short questions for you.

One, the State PUC commissioners testified before the subcommittee last week, I believe, that they were extremely concerned, as Mr. Tauzin said, about the representation at the negotiating table, if you will, of the Bell operating companies, that the leadership of the operating companies didn't know whether it was going to be leading operating companies or working at 195 Broadway, and therefore their incentives were somewhat confused. They took a formal position or vote, as I understand it, saying that they thought the split, divestiture should occur first and then sit down and discuss all of these asset evaluation-asset transfer issues that we have spent a lot of time today talking about.

I just wondered if you had any comments on that.

Mr. **Wunder**. The divestitures? How would that divestiture occur?

Mr. **Aylward**. There would be a stock split first. You would have independent companies which would then sit down at the table and transfer the assets required under the settlement.

Mr. **Wunder**. What would the value of the stock be based on?

Mr. **Aylward**. I am asking you for an answer.

Mr. **Wunder**. I don't know how you would do that.

Mr. **Aylward**. They made the suggestion and it certainly solves the independence issue.

Mr. **Wunder**. How do you do that? How do you value the stock? You mean you are going to get a stock of no value.

Mr. **Aylward**. The subcommittee needs jurisdiction over Wall Street?

Mr. **Wunder**. I don't know how you would do that. Maybe it is my lack of——

Mr. **Aylward**. Could you send a response up to the subcommittee on that?

Mr. **Wunder** [continuing]. A lack of total expertise on corporate financing.

Mr. **Aylward**. The subcommittee staff now has that expertise.

The second question is your basic premise on the A.T. & T. structure issues, that there is a lot of uncertainty left in what the court is doing.

Mr. **Wunder**. Could be, yes.

Mr. **Aylward**. That the subcommittee should let the dust settle. My question is what is the uncertainty? It seems to me, at least, that the uncertainty is the number of operating companies. The major issue is how many operating companies there will be, and that may affect the viability of operating companies.

It may affect network procurement issues and how competitive that market will be, but other than that, the uncertainties really have to do with the mechanics of asset evaluation, the prices at which things are transferred and so on, all of which are not answered by S. 898 or H.R. 5158 or H.R. 6121. All those bills do is establish to one degree or another procedures for making those transfers, but they don't resolve the issues.

So in a situation where Congress has been trying for 5 or 6 years to set policy in this area, where the Senate has passed a bill which is still relevant in great part, as you suggested, my question is—and as Mr. Wirth and the other members have pointed out—so many other issues are on the table. Why not go ahead and address that? What is the great uncertainty?

Mr. **Wunder**. I think the great uncertainty is that you proceed on that option only if one assumes the settlement is going to be accepted by Judge Greene in the form that it is currently in. It seems to me there are other options.

Second, you could reject it. Third, there is another potential option. Let us say Judge Greene says, "Well, this is a fine settlement that you all have entered into. But if you could, could you all agree on these two things that would change the nature of the settlement in some material way?" You may have altered the terms, so that the settlement that you may have crafted your legislation around is different. You would have done it significantly different had you known this was going to occur. I think that is the nature of the uncertainty.

I think I would couple it with the fact that you do not know the totality of the reorganization plan. I think there are a number of issues that flow off that. With the combination of those factors, what we are suggesting is, look at structure in the aftermath of that. And see if, from your perspective, that is a viable approach, or you need further structural change.

But deal with the issues that you can deal with now. As you know, there has been a consensus in the Congress for some time, but we never could get passed primarily because we have always butted up against the A.T. & T. structure issue.

Mr. TAUZIN. Mr. Markey, any further questions?

Mr. MARKEY. My only question is, I guess you imply that there is a certain amount of harm that Congress could do by taking precipitous legislative action pending the finalization of the consent decree. What harm do you think Congress could do, would do, if we acted in these areas that you proscribe?

Mr. WUNDER. No, I would not use the term harm at all. But it seems to me what I am suggesting is that, if you want to legislate and deal with these issues, there are times to do it and times not to do it. You could legislate and not create any significant harm except maybe harm to your legislation. Your legislation may be unilaterally amended by a court action. It may require you to go back and do legislation again.

I think if you structured it, if you bifurcated it, if you will, and dealt with the nonstructural issues, you know, it would not impact upon the decree. You see what the results are of the settlement, if there are any results; and then you deal with the structural issues, if you want to. That is the approach I am suggesting.

Mr. MARKEY. But do you——

Mr. WUNDER. I do not see any harm.

Mr. MARKEY. So if we went forward, took a look at some of these areas we have been discussing today, and passed legislation, you would not foresee it having any effect upon the consent decree, and perhaps would only necessitate additional legislative modification next year to accommodate the consent decree?

Mr. WUNDER. I remember something you told me 2 years ago, that legislation in this area is not very easy to pass, because we have been working on it a long time. Under the scenario that you have just outlined, you not only wanted to pass one bill, but you wanted to pass two bills. I say that is a very hard job in this area.

Mr. MARKEY. But I, in saying it was difficult, did not say it was not necessary.

Mr. WUNDER. I do not think it is. What I am saying to you, is that I do not think it is necessary. I think there are things that would be very productive to do right now that would be noncontroversial. What you are talking about doing is two controversial bills.

I am suggesting you do the noncontroversial bill, do something there is consensus on. In 1980, there were a lot of issues on H.R.

6121—what I am saying is separate out the two, and deal with the structural issues later.

Mr. MARKEY. I clearly have some disagreement with you. I think that we should move forward. I think the momentum is there now. I do not think it was there in past years. I think people have a much more sophisticated understanding of the effects of this kind of legislation. I do not think that was present in the past.

Those were the apprehensions I had. I think to a certain extent they were major contributors to the inability of the Congress to be able to pass legislation, that great uncertainty I think this has had great ameliorative effect upon the whole process, upon the education of the members here. I would not want to lose an opportunity to legislate in areas where a consensus was developing on the subcommittee, especially.

I do not think that was present in the past, if we were able to wrap ourselves around areas that clearly needed addressing and could receive the agreement of the Congress.

Mr. WUNDER. You may have to do it with a second piece of legislation. I do not see your expertise vanishing between now and next year.

Mr. MARKEY. But the climate that would perhaps create the momentum that would make legislation possible could disintegrate. That is my great fear. There is a sense of urgency now that Congress feels. I would hate to lose that opportunity, and perhaps then begin to defer it to a court in its decree, and see an institutional inertia again overtake this body as it did for a couple of decades. Thank you.

Mr. TAUZIN. Mr. Wunder, it is an election year. So expertise does get wiped out rather dramatically.

Mr. WUNDER. No, no. I have known many for several elections, and it does not.

Mr. TAUZIN. Thank you. The minority counsel, Mr. Joyce, has a question.

Mr. JOYCE. I just thought I might ask you a few questions about some of the specific provisions in the bill, and as to what administration's position may be on those provisions.

First, on the subject of forbearance from regulation authority given to the FCC not to regulate in areas where competition exists, or where there is a lack of market power, probably everyone agrees with that principle.

The FCC Chairman stated today that one of the areas that he would urge the Congress to legislate on would be in that area. In your statement you indicate the same thing. If there is any controversy at all on that particular subject, it is over how you define where competition exists or how you define where there is or is not an absence of market power.

H.R. 5158 would prohibit deregulation of, let's call them traditional telephone companies who own their own transmission facilities, unless, as I read it, there is duplicate transmission network owned by someone else covering most of the United States. In other words, it would not—and furthermore, that duplicate transmission, duplicative transmission network would have to be providing the same service.

In other words, the bill does not take into account resale competition, such as is being offered, for example, by Southern Pacific, or, to a great extent, by MCI and others as counting toward providing competition to the traditional telephone companies, nor does it take into account the fact that barriers to entry may or may not be high or low.

In other words, in fact it is possible, it seems to me, that an argument could be made that, although there is not now someone presently providing competing service, if it is true that the barriers to entry happen to be low, that may account as a strong—may provide some strong assurance that the existing supplier of that particular service, although he has very, perhaps 100 percent of the market, does not exercise predatory, engage in predatory pricing.

I just wondered what administration's position would be on those two questions, No. 1, resale competition ought to count in determining whether competition exists, and, No. 2, whether the existence of low barriers to entry ought to count.

Mr. WUNDER. I think the answer is yes on both points, that they probably ought to count. That is the way we have looked at this, and we supported the effective competition test that was in S. 898, which looked at essentially substitutable services and the number and size of unaffiliated carriers in the marketplace. That would be the type of effective competition test that we would favor, and have.

Mr. JOYCE. My long question, you have such a short answer.

Mr. WUNDER. Well, you covered most of it in the question.

Mr. TAUZIN. Mr. Wunder, we appreciate very much your appearing and testifying today.

Unless there is any further business before the subcommittee, the committee stands adjourned.

[Whereupon, at 12:51 p.m., the hearing was adjourned.]

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PERSPECTIVE OF INDEPENDENT TELEPHONE COMPANIES

THURSDAY, FEBRUARY 18, 1982

House of Representatives,
Subcommittee on Telecommunications,
Consumer Protection, and Finance,
Committee on Energy and Commerce,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2123, Rayburn House Office Building, Hon. Timothy Wirth (chairman) presiding.

Mr. Wirth. The subcommittee will come to order.

This morning we resume our hearings on H.R. 5158, the "Telecommunications Act of 1981," together with our continuing examination of the proposed settlement of *United States* v. *A.T. & T.*

Today we will hear from some of the nearly 1,500 independent telephone companies that together serve one-fifth of the American people. Over the years, these companies have brought high-quality telephone service to small towns and sparsely populated areas across the country as well as some of the major metropolitan areas. In doing so, they have played a key role in making electronic communication available on a nearly universal basis. And, in partnership with A.T. & T. and with one another, the independents have established long-distance communications links among communities of all sizes.

As competition develops in the communications industry—indeed, as Congress establishes the ground rules that will encourage the development of competition on fair terms—we must pay close attention to the needs of the customers of the independent companies.

We must insure that the transition to a competitive environment is managed smoothly, and that the access charge system intended to replace the current separations-and-settlements process does not inadvertently undercut our commitment to universal service. H.R. 5158, I believe, can meet these goals.

The settlement has brought into sharp relief such issues as the continued availability of telephone service at reasonable rates; the maintenance and improvement, particularly at the local exchange level, of our telephone system's high quality; and the development of full and fair competition throughout the telecommunications industry.

These issues must be resolved in a manner that encourages the maintenance and improvement of the telephone network upon which our citizens depend for basic communication, commerce and national defense. Legislation, and not the order of the court, is the appropriate vehicle for establishing policy in this crucial field.

We will also hear today about the special problems of providing local and interexchange service to the State of Alaska. A well-functioning communications network is essential to link Alaska with the "Lower 48," and we must insure that universal service is available to all Americans at reasonable rates.

We look forward to the testimony we will hear this morning. Before proceeding, I would ask my colleague from the State of Iowa, Mr. Tauke, who in his State has more independent telephone companies than any other State in the Union, if he has any comments he would like to make.

Mr. Tauke. Thank you very much, Mr. Chairman.

Mr. Chairman, it is quite clear that the settlement between A.T. & T. and the Justice Department has caused us to address a number of new issues. Those new issues are of particular concern, I think, to the people with whom we will be speaking this morning.

It occurs to me that questions about access charges, about the viability of local operating companies, concerns about the extension or the assurance of universal service at reasonable rates are all questions that have come into focus as a result of the agreement between A.T. & T. and the Justice Department.

So, this hearing this morning should perhaps focus as well as any we have held on the issues that have most concern to us now as we attempt to look at the legislation that has been offered, H.R. 5158, in light of the proposed antitrust settlement.

I look forward as you do to hearing the witnesses this morning, and having an opportunity to question them.

Mr. Wirth. Thank you very much, Mr. Tauke.

Witnesses, please join us at the table. I think you will find appropriate name plates there. I hope the names are all spelled correctly. I might say we greatly appreciate the help of all of you in assisting us in understanding the unique issues that you face. I want to thank you for your great help to me, members of the subcommittee, and members of the staff, in sorting through this very complicated legislation. The technical amendments we have been working on for the last 8 weeks, with which you all have been very helpful in helping us to understand some of the innuendoes, meanings and so on, should be available very shortly. I think they will reflect a great number of your concerns and input to us which has been very useful.

From my right to left, from your left to right, we have Mr. Theodore Brophy, chairman of the board of GTE. Paul Henson, chairman of the board of United Telecommunications. Charles Wohlstetter, chairman of the board of Continental. Robert Reuss, chairman of the board of Central Telephone and Utilities in Chicago, and Richard Lumpkin, president and chief operating officer of Illinois Consolidated Telephone.

Gentlemen, thank you all for being here. I think you all know the rules of the subcommittee, the general procedures. We would hope you would be able to summarize your testimony. Then we will have some time to react to what each of you says, and then get into an exchange with the committee.

Mr. Brophy.

STATEMENTS OF THEODORE F. BROPHY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GENERAL TELEPHONE & ELECTRONICS CORP.; PAUL H. HENSON, BOARD CHAIRMAN, UNITED TELECOMMUNICATIONS, INC.; CHARLES WOHLSTETTER, BOARD CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONTINENTAL TELEPHONE CO.; ROBERT P. REUSS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CENTRAL TELEPHONE & UTILITIES CORP.; AND RICHARD A. LUMPKIN, PRESIDENT, U.S. INDEPENDENT TELEPHONE ASSOCIATION

Mr. BROPHY. Mr. Chairman, members of the committee, my name is Theodore F. Brophy, and I am chairman and chief executive officer of General Telephone & Electronics Corp., known as GTE. I have filed a written statement which describes our telephone and other communications operations and respectfully request that that statement be incorporated in the record.

Mr. WIRTH. Without objection, your statement and those of all of you will be included in the record.

Mr. BROPHY. Thank you.

I would like to compliment the chairman and the members of this committee for pressing forward with legislation at this critical time in the history of the telecommunications industry. You are to be particularly commended for examining the issues from the point of view of the benefit to the public.

As you have recognized, deregulation is not an end unto itself but only a means to an end. The end result must be better service to the public at reasonable rates or deregulation and the legislative effort cannot be counted a success.

The press has reported that some people suggest the proposed settlement of the A.T. & T. antitrust suit makes legislation unnecessary at this time. In my opinion, nothing could be farther from the truth.

In fact, that proposed settlement makes legislation even more critical than it was before the agreement between the Department of Justice and A.T. & T. This is so because (A), the proposed decree would, in effect, restructure the telecommunications industry and establish national communications policy in an extraordinary procedure involving only A.T. & T. and the Department of Justice. (B), it disregards the existence of the independent telephone industry. (C), it would permit a diversion of revenue from the exchange carriers and threaten a substantial increase in cost and deterioration of service to the small business and residential users. (D), it fails to address the important issue of continuing responsibility for network planning which has serious implications for the integrity of the network and its ability to respond to national emergencies. (E), it deprives the Bell operating companies of both their interexchange facilities and their business of providing terminal and related devices to their customers. By doing so, it not only raises serious questions as to the long-term financial viability of those companies, but it leaves unanswered critical questions with respect to the future use of, and the recovery of investment in, the interexchange facilities and customer premises equipment currently on the books of the independent telephone companies. (F), the proposed settlement would leave A.T. & T. with clear monopoly power in two major markets in the United States, the provision of interexchange communications service and the manufacture of switching and terminal equipment. These monopolies would be free of the safeguards voluntarily accepted by A.T. & T. in the 1956 consent decree and, without appropriate accompanying legislation, could create rather than eliminate an anticompetitive environment. (G), the proposed decree also leaves unanswered the question of whether or not the residential user will be benefited by or even satisfied with the need to deal with three or more providers of service and equipment in order to obtain telephone service that has been customarily available from a single source. (H), the important subject of equitable capital recovery for the telephone industry in a competitive environment is a subject that is not dealt with by the proposed consent decree and must be covered in legislation.

Because time is so limited, let me explore with you the implications of just one of these problem areas arising out of the proposed settlement and requiring a legislative solution. That is the opportunity for A.T. & T. to deprive the exchange carrier of either a share of toll revenue or an access charge, thus increasing the burden on the exchange customer.

The proposed settlement places all the restrictions and burdens on the Bell operating companies which are relegated to the role of providers of basic service. A.T. & T. becomes the dominant provider of interexchange service—both interstate and intrastate—with over 96 percent of the interexchange facilities and traffic and subject to no restrictions.

In fact, Assistant Attorney General Baxter assumes that A.T. & T., shortly after entry of the decree, will be freed of all regulation.

Unlike the Bell exchange carriers, which will be required to interconnect with or provide access to all interexchange carriers, A.T. & T. will be under no obligation to provide facilities or services to either competitive interexchange carriers or even to exchange carriers.

It has been suggested that you need not fear local service-rate increases resulting from loss of revenue support previously provided by interexchange toll service. It is said the local companies can charge an access charge to the interexchange carriers, thereby supplementing the exchange revenues and holding down local rates. The fatal flaw in this argument is the failure to recognize that 60 percent of total interexchange business messages is generated by 4 percent of business customers. There is nothing in the proposed consent decree which would prevent A.T. & T. from building transmission facilities directly to the heavy-volume generators of traffic, thereby circumventing the local exchange carrier and avoiding the payment of an access charge. The implications for the local exchange user are obvious. The access charge cannot be assumed to provide continuing support for local rates, and local rates would have to be multiplied.

When you consider this example, you must realize that while the Bell operating companies, under the proposed settlement, will have no interexchange facilities, the independent telephone companies, not being parties to or subject to the proposed settlement, will continue to own interexchange facilities.

The process of selective circumvention of the local network will not only deprive the independents of an access charge or a portion of toll revenue but could over time make their investment in interexchange facilities valueless.

If there were time for me to examine with you each one of the settlement created problems that I have mentioned, I could show you equally compelling reasons why legislation during this session of Congress is imperative. But let me refer briefly to an issue not created or resolved by the proposed settlement but one that also requires a legislative solution if telephone carriers are to survive in an competitive environment and give their customers the benefits of advanced technology.

Telephone carriers, to compete, must be able to recover their capital on the same terms as other high-technology companies. To achieve this, legislation must assure recovery of the capital which telephone carriers have invested in regulated facilities. Therefore, any capital recovery provisions in the legislation must contain the following three elements: (1) There must be national depreciation methods and schedules which achieve capital recovery of embedded investments within their remaining life. (2) Federal and State regulators must permit full recovery of investments made pursuant to regulated service obligations. (3) Carriers must have the right to select capital recovery methods and schedules for new investments that meet those of the competition.

As you proceed with the extremely important task which you have started so well, let me raise one note of caution. While deregulation has an attractive ring to it and is a popular concept today, it can, if approached with inadequate sensitivity, become a trap.

I believe that the jury is still out on the success of airline and trucking deregulation. The public clearly would not stand for the perturbations in pricing and service in the telephone industry that we have seen take place in the airline industry. I know that the rewrite of the Communications Act is an extremely complex task, and Congress has before it an agenda of other grave and critical issues, but I suggest that a failure to deal with the telecommunications legislation promptly and effectively will create problems for this infrastructure industry that will impact every man, woman, and child in the United States in the future.

Therefore, I commend you, Mr. Chairman, and members of this subcommittee, for your foresight and urge you to proceed promptly and aggressively with your work on a bipartisan basis so that we can remove the uncertainty that now overshadows the whole of the telecommunications industry, so we can get on with our jobs of providing the best communications service in the world at reasonable prices.

Mr. Chairman, we would respectfully seek an opportunity to file a supplemental memorandum with any constructive suggestions that might occur to us after we have had an opportunity to study the specific language.

Thank you.

[Testimony resumes on p. 726.]

[Mr. Brophy's prepared statement follows:]

Statement of

THEODORE F. BROPHY

Chairman and Chief Executive Officer
General Telephone & Electronics Corporation

before the

House Subcommittee on
Telecommunications, Consumer Protection and Finance

Mr. Chairman, Members of the Subcommittee:

I am Theodore F. Brophy, Chairman and Chief Executive Officer of General Telephone & Electronics Corporation. GTE operates the largest independent (non-Bell) telephone system in the United States. Its domestic telephone subsidiaries serve approximately 15.8 million telephones and operate in thirty-one states. GTE's Telenet subsidiary operates a nationwide public data communications network as a competitive "enhanced services" vendor. GTE Satellite Corporation is building an advanced satellite system which will be operational in 1984. GTE also is a major manufacturer of telecommunications systems and equipment, lighting products, precision materials, and electrical products.

GTE applauds the work of the House Subcommittee on Telecommunications, Consumer Protection and Finance because the Subcommittee is addressing vital issues concerning the future of the telecommunications industry. Your legislative effort stands apart because you attempted not to deregulate the telecommunications industry as an end in itself, but rather focused on how, if and when, deregulation will benefit the public. Because of this focus, this Subcommittee's efforts are a major step forward towards creating a fair and competitive climate for telecommunications.

Telephone service is an essential part of everyone's daily life, and it must continue to be universally available at reasonable rates. Furthermore, a closely integrated telecommunications system is essential to our national security. As H.R. 5158 recognizes, in order to continue to meet these requirements, some regulation for the foreseeable future, as well as legislation, will be required.

AT&T - JUSTICE SETTLEMENT

Before discussing some specific areas where H.R. 5158, in our opinion, needs strengthening, I will first discuss the recent AT&T-Justice Department settlement and show how the deficiencies of the settlement underscore the urgent need for legislation. The settlement directly affects only the Bell System. While the Bell System owns a large majority of telecommunications facilities in the United States, there are 1400 independent telephone companies which are not parties to or bound by this settlement. Many of these independent companies provide interexchange services;

they all provide exchange services and Customer Premises Equipment (CPE). The settlement alone therefore cannot establish national telecommunications policy or substitute for action by the Congress.

The following are some specific deficiencies of the settlement which should be corrected by legislation.

First, the settlement threatens the economic viability of local telephone service by permitting AT&T to siphon off the profitable segments of local telephone service. The local exchange carrier is dependent on the combination of local customer rates and access charges to obtain revenues required to finance and modernize its facilities. But the settlement permits AT&T to build transmission facilities which would directly connect its interexchange facilities to customer locations, thereby bypassing the Bell Operating Companies (BOCs) and independent telephone company local exchange facilities. AT&T already has interexchange switches in all major markets well positioned to bypass local exchange facilities with modern technology such as Digital Termination Service.

Today 4 percent of the business customers generate over 60 percent of the total business interexchange messages. AT&T could therefore selectively install such directly connected transmission facilities to serve high-volume customers, such as large businesses and government entities, which generate a substantial portion of all interexchange calls. If access revenues are reduced due to AT&T's bypassing the local exchanges to provide interexchange service, it will be necessary to raise customers' local rates to make up the revenue shortage. The BOCs and independent telephone companies would eventually be left with only the lower-volume, higher-cost customers to serve, which would quickly lead to higher local telephone rates.

Second, the settlement would leave AT&T with monopoly power, with few restraints, in two major markets -- 96 percent of the interexchange market and more than 60 percent of the significant equipment markets.[1/] If AT&T is allowed to operate without separation of its regulated and unregulated businesses, opportunities for cross-subsidization will continue to exist at the expense of competition in telecommunications markets.

Furthermore, the research and development activity of Bell Labs and the manufacturing capability of Western Electric were paid for by all ratepayers as a result of AT&T's long-term regulated monopoly position. The payments were made by BOCs through the license fees paid to Western Electric and Bell Labs

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[1/] See attached Charts A-1 and A-2.

and through the purchase of products from Western Electric. Also, the ratepayers of the independent telephone companies made payments through the separations and settlements process. These enormous ratepayer-financed facilities and the technology base, such as the costly Advanced Communication System (ACS) development, will give AT&T an overwhelming competitive advantage.

Finally, the settlement provides that Western Electric must give priority to meeting the manufacturing needs of the BOCs until September of 1987. This requirement, coupled with (a) the long manufacturing lead time for much of the equipment, particularly central office switching equipment, (b) established patterns of procurement based on decades of custom and usage, and (c) elimination of the requirement of the 1956 Consent Decree that AT&T and Western Electric license their patents and provide technical information to other manufacturers, will continue to link the BOCs to Western Electric beyond 1987. The result will be the continuation and extension of AT&T's monopoly position in the principal telecommunications markets, unless the Congress takes action to ensure development of competition in those markets.

Third, the settlement attempts to reverse the FCC's Computer II decision by transferring on a "flash cut" basis the BOCs' embedded Customer Premises Equipment (CPE) to AT&T. This would give an enormous competitive advantage to AT&T. It would inherit a fully operating CPE business with assets of approximately $10 billion. Such a business would be born with established customer relationships and records for 80 percent of the nation's telephone users. Furthermore, that business would have approximately 1400 retail outlets established under regulation, with all of the start-up costs paid for by local ratepayers.

Fourth, the settlement reduces competition by prohibiting the BOCs from competing with AT&T in the provision of new terminal equipment. This effectively relegates the CPE business to AT&T. The BOCs could be important competitors in that market. Furthermore, their presence in this market would help them remain economically viable.

Fifth, the settlement compounds this reduction in competition by its failure to require outside procurement of CPE by AT&T. Without outside procurement, the Western Electric share of the CPE market and the components submarket will steadily increase.

Sixth, the settlement permits the 22 Bell Operating Companies to form a vast new entity through consolidation or through the creation by the BOCs of a centralized organization for procurement, engineering, administrative and other services. Open competitive procurement of equipment by the BOCs will be improved if there is a large number of independently owned and independently acting BOCs and their reliance on Western Electric is diminished.

Seventh, the settlement creates uncertainties concerning the continuation of jointly provided telephone company interexchange services. For years, AT&T, the BOCs and the independent telephone companies have jointly provided interexchange services. The settlement provides that the BOCs will transfer to AT&T all of the BOCs' interexchange facilities, the BOCs will no longer be permitted to provide interexchange services and the existing division of revenues process between AT&T and the BOCs will be terminated.

GTE and other independent telephone companies are concerned about the impact of these proposed rearrangements on their division of revenues arrangements with the Bell System and on their investments in interexchange facilities. GTE alone has interexchange investment in excess of $2.4 billion.

If GTE and other independents are to continue to provide interexchange services, the present arrangements for joint provision of interexchange services must be replaced, and reflect the investment of GTE and other independents in interexchange facilities, the continued participation of GTE and other independents in the planning for the provision of joint interexchange services,
the pooling of the costs and sharing of profits of the jointly provided interexchange services.

Eighth, the settlement relieves AT&T of all restrictions under the 1956 Consent Decree without providing any safeguards to protect competition. Under the 1956 Consent Decree, in exchange for retention of its telecommunications monopolies in equipment and services, AT&T was restricted to providing regulated common carrier communications and businesses and services incidental thereto. The 1956 Consent Decree further required AT&T and Western Electric to grant licenses for their patents and to provide persons domiciled in the United States and not controlled by foreign interests technical information on a reasonable nondiscriminatory basis. During the period 1956 to 1982, AT&T continued to increase and receive benefits from those monopolies.

Equipment and software were developed by Bell Labs and manufactured by Western Electric for use by the

BOCs and Long Lines. The standards and specifications for such equipment and software were entirely developed within the AT&T organization; as a result much of this equipment and software is unique to the Bell System.

In 1956, the BOCs and Long Lines purchased the vast majority of their equipment from Western Electric. Even with recent pressure to widen their purchasing practices, almost 75 percent of their equipment needs are still supplied by Western Electric. In at least one major category, network switching equipment, Western Electric supplies in excess of 95 percent of the BOCs' equipment needs.

The settlement will allow AT&T to retain many of the fruits of these regulated monopolies. It will also permit AT&T to enter any other business without separation requirements or other safeguards against further monopolization through cross-subsidization from its remaining regulated businesses. Failure to enact legislation which prevents cross-subsidization and requires licensing of patents and technology will seriously impair competition in the telecommunications markets and undermine the modest progress in opening these markets made since 1956.

Ninth, the settlement requires a fundamental change in the responsibility for the technical integrity of the nationwide telephone network. The settlement will dramatically change the circumstances under which the nationwide network is managed. The BOCs, AT&T and the independent telephone companies will no longer be jointly responsible for end-to-end basic, regulated service. AT&T will become an interexchange services provider -- one of a number of such providers which will be making connections to local exchanges for purposes of completing their customers' calls.

Under these changed circumstances, it should become the responsiblity of the local exchange carriers to assure the technical integrity of the network by planning for the technological evolution of the network as well as establishing the standards for connection to exchanges by interexchange carriers. A consortium of the local exchange carriers, including the BOCs, should be authorized to establish and implement these technical characteristics.

Tenth, the settlement does not require AT&T to interconnect to all local exchange carriers. AT&T must continue to have an obligation to provide regulated interexchange services to all local exchange carriers, to insure continued universal sevices and protect the national security.

Finally, the settlement does not address the technological changes in telecommunications which have rendered the 1934 Act obsolete in many areas. The 1934

Act was founded upon theories of natural monopoly in a period when voice communications by wire were dominant. These theories have been outdated in many markets by technological change. Orderly development of competition in those markets will occur only if the law is restructured to provide for orderly and appropriate deregulation.

AREAS IN WHICH H.R. 5158 SHOULD BE STRENGTHENED

The failure of the proposed AT&T-Justice Department settlement to resolve these problems emphasizes the need for a comprehensive legislative solution which creates a coherent national telecommunications policy. H.R. 5158 addresses many of the deficiencies of the AT&T-Justice settlement, but should also be strengthened in the following areas:

a) The bill must assure recovery of the capital which telephone carriers have invested in regulated facilities. Therefore, any capital recovery provisions must contain the following three elements:

> (1) There must be national depreciation methods and schedules which achieve capital recovery of embedded investments within their remaining life.
>
> (2) Federal and State regulators must permit full recovery of investments made pursuant to regulated service obligations.
>
> (3) Carriers must have the right to select capital recovery methods and schedules for new investments to meet competition.

b) The speed and degree to which procurement by AT&T and its subsidiaries (including the BOCs) is opened to non-affiliated manufacturers must be increased. The bill requires that outside procurement be increased by a factor each year to a maximum 30 percent procurement from non-Western Electric sources in the 1990s. These annual factors must be increased to develop effective competition to Western Electric and to avoid another decade of dominance. Starting from a very low minimum of 8 percent outside purchasing, GTE recommends that such purchasing be increased by a factor of 40 percent a year beginning the second year after enactment of legislation, until a 40 percent third-party procurement is achieved by 1989.[2]

GTE feels that the mandatory procurement provisions of legislation should apply to the divested BOCs. We recognize that the settlement requires that the BOCs have an open purchasing policy, but past practices must be firmly altered if a truly competitive telecommunications equipment market is to evolve.

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[2] See attached Chart B, which graphically shows this development for network switching equipment.

Further, in view of the importance of a viable domestic telecommunications industry to national security, the outside procurement provisions of the bill should be amended to foster the growth of domestic manufacturers controlled by U. S. citizens. Like AT&T, many foreign manufacturers have attained enormous economies of scale through closed markets. Such foreign manufacturers are in a position to expand rapidly their presence in this country and thereby to substantially inhibit the development of a diverse, pioneering U. S. industry.

c) Cost allocations to long-distance service, to support local services, must be reduced to deter erosion of traffic from the national public switched telephone network and to deter bypass of the local facilities by interexchange carriers. If the cost allocations underlying access charges are not rationally-based, interexchange carriers will connect directly with high-volume users, leaving only low-volume traffic for the network. This becomes of critical importance since AT&T under the settlement is permitted to bypass the local exchanges. If the level of access charges to interexchange carriers are not competitive, interexchange carriers, and especially AT&T, because of its enormous size and financial capability, will quickly act to connect interexchange services directly to high-usage customers.

Therefore, a prohibition on AT&T's bypassing the local exchange is required until the cost allocations supporting local services are reduced. Further, if traffic erodes from the public switched network, it will not be economic to maintain adequate service connections to all exchanges, especially those sparsely populated, more rural exchanges.

d) The current level of payments by specialized carriers to telephone companies for exchange connections must be maintained until all interexchange carriers are paying equal access charges. If these charges decrease to business line rates, as the bill now provides during the transition period, revenues to exchange carriers from interexchange access charges would decline, inevitably leading to higher local telephone rates.

e) The unregulated subsidiaries of AT&T must not be allowed to provide services similar to the basic service of AT&T. If AT&T and its subsidiaries offer similar services through both regulated and unregulated entities, AT&T will selectively serve high volume customers through its unregulated entities. The result will be serious erosion of revenues from the network and higher rates for basic long distance service for the remaining lower-usage customers.

f) A joint network consortium of all local exchange providers should be created to establish standards for interconnections with interexchange carriers. Such a consortium is necessary to protect the technical integrity of the telecommunications network and to meet national defense requirements.

Finally, some suggest that AT&T need no longer be treated as "dominant" because of the spinoff of the BOCs. In view of AT&T's 96 percent share of the interexchange market and its overwhelming position in research and in equipment manufacturing, these suggestions cannot, in my view, be taken seriously.

CONCLUSION

GTE welcomes and supports your efforts toward deregulation of telecommunications services and fostering an environment of fair and open competition. You can be assured that the resources of GTE will remain available as you continue your work on this important legislation.

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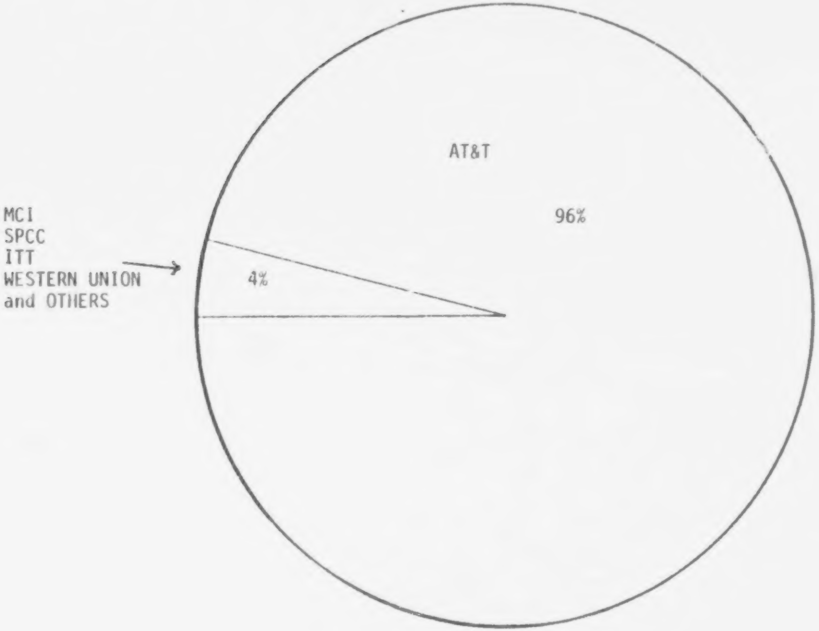
CHART A-1

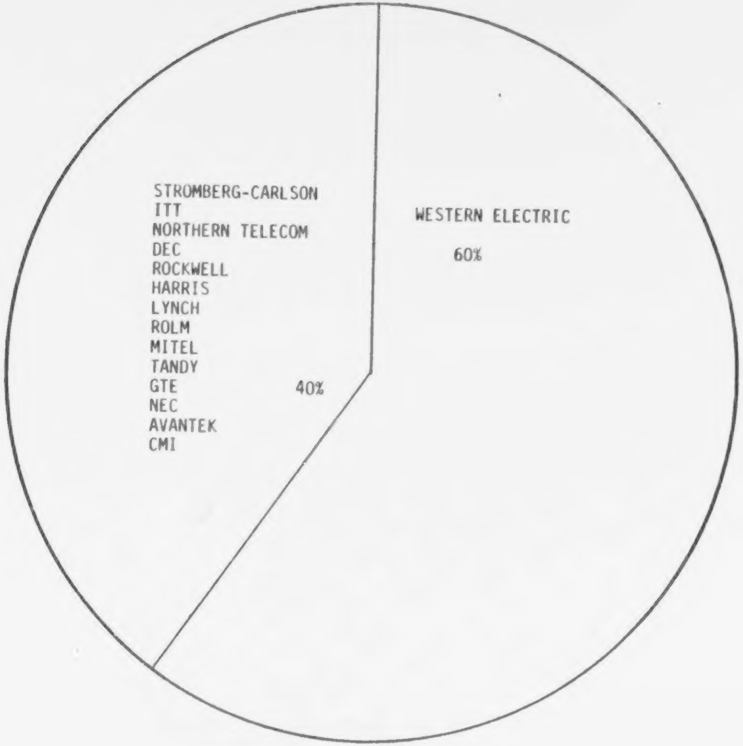
INTEREXCHANGE TELECOMMUNICATIONS MARKET



COMPETITIVE SHARES

CHART A-2

MANUFACTURE OF TELECOMMUNICATIONS EQUIPMENT TO U.S. DOMESTIC MARKET

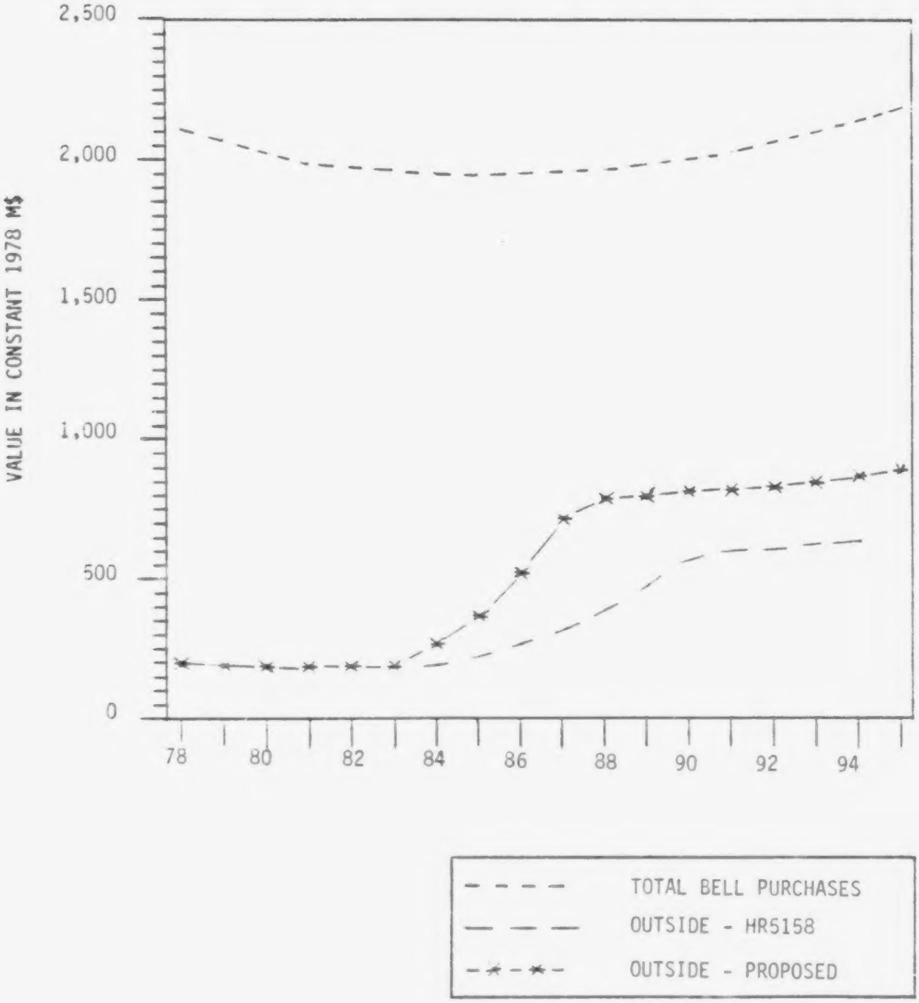


COMPETITIVE SHARES - 1980 $12.5B

CHART B

ALTERNATIVE PURCHASING PATTERNS
OF
CURRENT AT&T OPERATING ORGANIZATIONS

NETWORK SWITCHING EQUIPMENT



Mr. **Wirth**. Thank you very much, Mr. Brophy. Of course the record will be open throughout these procedures for comments and input. We are certainly looking for all the help we can.

Mr. **Brophy**. Thank you.

Mr. **Wirth**. Mr. Henson.

STATEMENT OF PAUL H. HENSON

Mr. **Henson**. Thank you, Mr. Chairman.

I am Paul Henson, chairman of the board of United Telecommunications, headquartered in the Kansas City, Mo., area. I very much appreciate this opportunity to express our views to this subcommittee. As Mr. Brophy has requested and as you have concurred, Mr. Chairman, I ask that our written submission be included in the proceedings. Mr. Brophy has made an excellent opening statement. I would simply like to enlarge on several points that Mr. Brophy registered, rather than be duplicative of what he had to say.

Certainly, I also commend this subcommittee and its staff for the efforts that you are making to sort out some very complex issues in telecommunications, recognizing that there are other and more pressing demands on your time. However, I think we are at the crossroads in the telecommunications industry. And, we can either establish some degree of certainty and direction in the industry, or we can go on with the rather haphazard ad hoc decisionmaking that we have had by regulatory agencies, and, indeed, by the courts.

We think that H.R. 5158 is a commendable piece of legislation that may well provide the framework for a national telecommunications policy that will benefit the users, the regulators, and the suppliers of telecommunications services in this dynamic industry.

I would like to key off of the chairman's letter of invitation to appear before this August body. I can only echo Mr. Brophy's sentiments and the chairman's sentiments that passage of legislation in this Congress is critical. I believe that the consent decree modification between the Department of Justice and A.T. & T. makes passage of legislation even more critical if the American telephone user and ratepayer is to be recognized in all of these deliberations.

The chairman expressed concern about the cost of telephone service and the quality of telephone service, and the possible impact on both cost and quality arising from the consent decree modification.

The conventional wisdom seems to be that local rates will not be affected, at the outset at least, by the consent decree. I agree, if the evaluation is confined to a short time frame. This is true if the only thing we are looking at is the immediate impact of the consent decree. However, I believe that there are some long-term implications in the consent decree that will indeed have an impact on local service rates.

Mr. Brophy has touched on several. One is the opportunity to bypass the local exchange network. Technology is making that possible today and will be even more so in the future. And, yes, access charges can be structured or formulated so as to retain local service rates at their approximate level today. But we all recognize that there must be some changes in the definition of cost of local exchange service, which comes about through changes in the separations procedures, if we are to compete in the intercity marketplace.

I think there is no question that the long-term impact of the consent decree is detrimental to local service rates. I suspect that this impact is not going to show up in our rates for some period of time. Yet, I think it is necessary that this impact be considered in these proceedings. Local rates will obviously increase as a result of the competitive policies of the FCC. Such policies are going to have the immediate impact on our rates. But how much impact no one is really able to quantify.

We have submitted local rate impact material to this subcommittee. I know others at this table have. We think that just with those changes that are now in prospect, and if we do change from SPF to SLU, or something in between, we are talking about roughly doubling our local service rates. That is going to vary. That is about what is going to happen in the United System as we price it out, 85 to 95 percent increases, once all of these changes are worked into our pricing systems.

The access charge mechanism as a substitute for the present system of dividing revenues among joint providers of services is really not directly related to local exchange rates. These are determined by the definitions of costs which originate with the State commissions and are finally approved by the Federal Communications Commission.

If the costs of local service increase, as defined in this manner, local rates can only increase. I would argue if we are really concerned about the American ratepayer, and I know that this committee is, that we proceed very slowly, very cautiously, as H.R. 5158 contemplates. I further submit that we should not attempt a complete redefinition of local service costs in the near future.

Many economists will argue that we have to get to cost-based pricing in a competitive marketplace, and I do not disagree. However, we have used cost aggregation and revenue pooling procedures in this industry for many years. We have minimized the economic dislocations that are caused by high-cost operations in rural, sparse, short grass country that we are used to serving.

These procedures should not be summarily dismissed overnight. This committee does not envision that they will be. If these procedures can be continued and gradually phased out, if we can have aggregation of costs and pooling of revenues on a broad basis—be it nationwide or statewide, the economic dislocations that we foresee will be minimized.

Again, if we have a period of time, 5 to 7 years to implement these changes, then I think the impact on the local ratepayer can be minimized. The quality of service is a very difficult matter to evaluate. Some of us have been concerned for the last 25 years, ever since the FCC above 890 case. I think that was in the mid-1950's, and I also happened to testify in that proceeding. I said somewhere, someday, there is going to be a degradation of service. Maybe I haven't been proven right, but I haven't been proven wrong, either.

And I think there is no question that the consent decree, the fragmentation of the Bell System does not bode well for service in the long term. Certainly when embedded CPE is transferred on a flash cut basis, and the Bell operating company subscriber is left to shift for himself and to pay two or three bills, I cannot believe that this is improving the quality of our national telephone service I consider convenience to be a part of the quality education.

Even more importantly long term is how the network is planned, and how the network is controlled. Separate and distinct from network control, which is really typified by the Bedminister, New Jersey network control center of A.T. & T. Long Lines, I am talking more about the design and the development of an integrated nationwide network that has served this country so well for so long. Much of this planning was derived from the resources of an integrated American Telephone & Telegraph Co.

Much of the planning was done by A.T. & T. Long Lines Division in collaboration with the Bell Telephone Laboratories. That relationship will still be intact. However, much of the design criteria necessarily flowed from the Bell operating companies. They serve that customer out there that is known as the end user. And they are the ones that really generate the requirements for the network. This coordination is going to be lost in the separation of the A.T. & T. and the Bell operating companies. It raises questions not only about network design and control, but indeed, about emergency preparedness, and our ability to respond as a disciplined network in times of emergency.

System control is a discipline that is necessary if we are to get the results that we desire, and if the network is to function efficiently and on a comprehensive basis in the furtherance of universal service. It is a discipline that all who participate in the provision of facilities must be in concert with if we are to maintain a reliable and comprehensive system.

The system, as I indicated, is usually defined from the outside in. The customer's requirements and the capabilities of the terminal devices control, the design of the switching, and the transmission functions. The system is totally interactive. One customer can control or can influence, in effect, all other customers. The intercity network is really a subsystem. If indeed there are islands, the intercity network is the island, and the local exchange companies, are the ocean.

The network control function formerly performed by the Long Lines cannot be continued under the separated corporation as envisioned by the consent decree.

I would hope that H.R. 5158 could address this network planning issue. You have addressed it. You have permitted local exchange carriers to meet together, to plan, to develop processes. I submit that there needs to be some organization formed, perhaps informal, perhaps formal.

The network planning function, if we are to maintain an adequate system in the future, must be the primary responsibility of the local exchange companies, be they the Bell operating companies or the independent companies represented at this table. Input is obviously needed from the intercity carriers, all of whom have a little bit different interest from this point forward, including the A.T. & T. Long Lines Division.

MCI, Southern Pacific, others, obviously, input to the process. But the responsibility for the continuation of quality telephone service in this country must necessarily pass to the local exchange companies. Mr. Chairman, I have exhausted my time, I am afraid. When I get on a subject like this, I tend to lose my terminal facilities.

We, too, would like to continue to work with the subcommittee and the staff as H.R. 5158 is perfected.

We are optimistic that this bill will provide the framework for a national telecommunications policy that will benefit all. Thank you, sir.

[Testimony resumes on p. 741.]

[Mr Henson's prepared statement follows:]

STATEMENT
OF
PAUL H. HENSON
CHAIRMAN OF THE BOARD
OF
UNITED TELECOMMUNICATIONS, INC.

Mr. Chairman, my name is Paul H. Henson. I am Chairman of the Board and Chief Executive Officer of United Telecommunications, Inc. ("United Telecom"). United Telecom is a telecommunications holding company, with subsidiaries that provide a wide range of telecommunications services and products, and data processing and software services.

Permit me to briefly describe United Telecom and its role in the telecommunications industry. United Telecom consists of four major groups, each one operated or administered by a separate corporate entity. The first group, the United Telephone System, comprised of 26 operating companies, is the second largest non-Bell telephone system in the country. In 1981, it had nearly five million telephones in service operating in small and rural communities in 21 states and an investment in plant in excess of $5 billion. It has approximately 26,500 employees, and had 1981 revenues of $1.6 billion.

The second group, United Communications Systems, is largely engaged in marketing competitive telecommunications services and products which are not regulated. The principal company within this group is North Supply Company. North Supply provides products to all segments of the telecommunications industry, including interconnect companies, international telecommunications markets, electrical utilities, security and alarm systems, and CATV systems. Sales of the Communications

Systems group in 1981 were approximately $486 million. This group continues to explore opportunities presented by emerging telecommunications technologies.

The third entity is the United Telecom Computer Group, which provides remote computing and software service, and computer graphic display terminals. Its revenues in 1981 were about $137 million. This group offers a wide variety of business, technical and financial services via communications networks serving over 150 cities linked to computer centers in Kansas City, Boston and London.

Finally, we recently announced the formation of a fourth group. This group will be engaged in the provision of enhanced, voice and data services in intercity telecommunications markets. This group presently consists of Uninet, a packet switched network, and ISACOMM, a resale carrier.

Mr. Chairman, I appreciate your invitation to present United Telecom's views on H.R. 5158, and to comment on the complex and controversial issues that confront users, regulators and suppliers of telecommunications products and services in this dynamic industry.

Today, we stand at the crossroads in telecommunications history. We can continue the endless debate as to how national telecommunications policy should be shaped, or we can adopt a national telecommunications policy which will restore certainty and stability to this vital industry. The time is ripe for prompt Congressional action on a new national telecommunications policy. The goals of that policy are clear and noncontroversial. Those goals are: the creation of an environment in which competition can flourish; the retention of regulation in those markets where effective competition does not now exist; and the preservation of universal basic telephone service at just and reasonable rates. Congress must provide the road map for reaching these goals. If Congress waits to act for even several months, as has been suggested by some, we will have gone beyond the crossroads where we now find ourselves. Failure to act now will leave the shaping of national telecommunications policy to the FCC, with questionable statutory authority to act, or to the courts, who are ill-equipped to make policy determinations. Their actions will result in piecemeal decisions lacking clear policy direction, extensive litigation and a continuation of the uncertainty and instability that have been part of the industry for so long.

Competition in telecommunications services can be beneficial, but only if it is implemented in a reasonable and orderly fashion. Economic dislocations among both industry members and the consuming public can be avoided if the transition from a regulated monopoly to a competitive marketplace is accomplished with due deliberation and concern for the legitimate interests of all parties. Congress is best equipped to perform this task.

The Consent Decree Modifications proposed by the Justice Department and AT&T do not alleviate the need for telecommunications legislation. Indeed, in some respects, they increase it. Some areas already requiring legislative attention remain unaffected by the Modifications.

Specific issues, pervaded by uncertainty, beckon for your attention. Among them is the issue of how to create an environment where market forces can be effectively utilized in developing and improving telecommunications services. Closely related to this are questions of the degree of regulation that is appropriate, both during the transition to competitive markets and once full and fair competition is achieved in those markets. The transition to competition raises questions involving the valuation of a telephone company's terminal equipment and implementation of interconnection requirements.

Other major concerns include the maintenance and improvement of the system which furnishes both interexchange and local services in a manner which the American public has come to expect. Changes in this system will affect not only the Bell operating companies, but also the Independent telephone companies. While these entities have been partners in the provision of joint through services, there is concern that the Independents will be excluded from the process. Existing arrangements through which the Independents participate in the growth and management of the total network will have to be restructured. Such changes also give rise to issues relating to access charges for local exchange and the effect of such charges on local rates.

Questions of jurisdiction over intrastate services must be considered. Also, the feasibility of restrictions on AT&T and its entities over and above those in the Consent Decree Modifications is raised, as well as the permissible offerings of the divested Bell operating companies.

H.R. 5158 provides a basic framework which addresses many of the issues facing the telecommunications industry today. United Telecom believes that changes need to be made to accommodate the concerns of the industry. We do have specific comments and recommendations on issues which affect United Telecom. If those suggestions are incorporated into H.R. 5158, we believe they will improve it and thereby reflect a national telecommunications policy which will serve the public interest.

Jurisdiction and Regulatory Authority

H.R. 5158 gives the FCC regulatory authority over all interexchange services and access to local exchange facilities. We believe this approach is sound, except that H.R. 5158 is not clear as to the extent to which states can exercise some form of concurrent jurisdiction with the FCC in determining the level of access charges. The revenues a local exchange carrier receives from access charges will be an important factor in determining how much local exchange rates must be increased. Accordingly, the states should be given sufficient regulatory authority, subject to Federal guidelines, to apply access charge revenues so as to mitigate dramatic increases in local exchange rates. For example, the states should be given authority to establish a uniform access charge within a state through the aggregation or pooling of costs and revenues associated with exchange access. State-wide pooling will also lessen the need for support of individual exchanges from the National Telecommunications Fund and will greatly simplify the administration of the Fund, if it is established. Revisions in H.R. 5158 are necessary to accomplish this purpose.

The states should retain primary jurisdiction over the provision of various local services and facilities, such as resale of services, the construction and operation of broadband facilities, and other services that have traditionally been provided by local exchange carriers. The states are better positioned to determine the need for regulation, if required, and the type of regulation that may be necessary to best serve the public interest. Limited revisions to H.R. 5158 are needed to make certain state jurisdiction is not unnecessarily preempted.

A further issue is the expanded regulatory authority given the FCC in H.R. 5158. United Telecom is particularly concerned with the Commission's increased power to classify carriers, the absence of concrete standards to be employed in such classifications, and the authority given the FCC as a result of such classification.

In this regard, we suggest that the criteria in H.R. 5158 for classifying regulated carriers should be modified so that the FCC applies the designation only to those carriers offering interexchange service or exchange access where it determines that Federal regulation is necessary to carry out the purposes of the bill and that the benefits of such regulation outweigh the costs. Once designated as a regulated carrier, such carrier's offering of competitive services should not be restricted by the FCC on the basis that insufficient competition exists for that service. The FCC's authority in this regard should be solely limited to instances where subsidies from that service to regulated services are likely. Also, in determining whether a particular service should be deregulated, the FCC should be governed by the standard of whether adequate alternative facilities exist, not the level of service being provided over those facilities.

FCC regulation of interexchange services and exchange access, as already discussed, is proper and necessary. However, by virtue of such regulation over interexchange services, the FCC should not be given authority over all other services that a regulated carrier may provide, nor should a regulated carrier with limited market share and geographic range be subject to Federal regulations designed to regulate carriers which provide services on a nationwide basis and who have a major share of such markets. H.R. 5158 should be revised to make certain it does not unnecessarily expand FCC authority.

The Network

H.R. 5158 mandates that interexchange services and facilities be universally available at reasonable rates. United Telecom remains dedicated to that objective and believes it should be retained as a legislative goal. In order to continue to provide such universal service and facilities, the existing nationwide network must be preserved and improved as new technology becomes available.

Several months ago, while testifying before the Senate Committee on Commerce, Science and Transportation, I expressed alarm over the "casual assumption made again and again that the nationwide switched network is really not threatened by competition." I stated that this reasoning was attributed to the erroneous belief that AT&T _is_ the network and that, no matter how the Bell System is restructured, the network would remain intact.

With the advent of the proposed Consent Decree Modifications, attention should now be focused on the challenge to maintain a comprehensive and integrated telecommunications system operating under a diversified structure of ownership and responsibility. Competing interexchange carriers will have conflicting goals, and none will necessarily be in full harmony with the objectives of the local exchange carriers. Thus, the problem of effective coordination has been made both more important and more difficult at the same time.

The provisions in H.R. 5158 which authorize the continuation of joint planning and management of "any network of telecommunications services or facilities" (Sec. 261), arrangements for restoration and security (Sec. 262), and standards (Sec. 241, 254 and 261) require rethinking in view of the proposed Consent Decree Modifications. The local exchange carriers, as a group, continue to have common interests and to offer the best hope of maintaining control over a single integrated system. It is not yet clear if they will have the legal or operational authority to do so. Until more information about the effects of the Decree is made known, we can only suggest that the bill permit full cooperation of local exchange carriers -- which are not generally in competition with each other -- to develop, publish and modify the common standards necessary to the maintenance and growth of an integrated telecommunications system.

Interconnection and Access Charges

H.R. 5158 imposes an interconnection requirement for all regulated services. Carriers providing exchange transmission services must provide equal interconnection to any interexchange carrier upon request.

United Telecom agrees with the imposition of an interconnection obligation. This is essential if there is to be a competitive environment in telecommunications markets. The critical issues for United Telephone operating companies, and others who must implement such an interconnection requirement, are the necessity for a transition period and the degree of technical parity mandated. A date certain should be established where equal interconnection is to be provided through all end offices having electronic, stored program switches. A waiver of this requirement should be available for those end offices which do not have such electronic switches, if it can be demonstrated that the cost of acquiring electronic switching or other means necessary to provide equal access would impose an unreasonable financial burden on the operations of the carriers serving such communities and ultimately upon telephone users. During the period when a waiver is in effect, equal interconnection should be provided if the requesting party incurs the additional cost necessary to provide such interconnection. In any event, the local carrier would be required to provide interconnection of the most advanced type and quality possible during the waiver period.

A system of exchange access charges, such as the one provided for in H.R. 5158, is essential to customers and carriers in a competitive telecommunications environment. The National Telecommunications Fund created in the bill includes three accounts. Participation in two of them is presently limited to carriers who along with all of their affiliates serve only a particular number of main stations.

United Telecom believes that the eligibility requirements for these two funds should be based upon the size of a specific local exchange and not the size of the carrier who operates the exchange. Thus, if the access charge to the local exchange is inadequate to prevent increases in local exchange rates, then the contribution from the two funds should be based upon the revenue requirements of that exchange and not the revenue requirements of the carrier who may operate a number of exchanges. To provide otherwise would result in one local exchange being subsidized by another. We also believe that the National Telecommunications Fund should serve as a transition mechanism to mitigate local rate increases and that, after an appropriate period, it should be phased out so that local exchange rates more clearly reflect costs of providing local service, as well as access to the local exchange.

Conclusion

In conclusion, United Telecom submits that telecommunications legislation is necessary at this time to provide stability and certainty to the industry, and to encourage the implementation of new and improved technology, for the benefit of the served public. Most importantly, legislation is needed to prevent dramatic increases in local exchange rates during the difficult transition period that lies ahead. H.R. 5158 provides a basic framework for resolving these objectives.

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Mr. WIRTH. Thank you, Mr. Henson.

Mr. Wohlstetter.

STATEMENT OF CHARLES WOHLSTETTER

Mr. WOHLSTETTER. Mr. Chairman, members of the subcommittee, I am Charles Wohlstetter, chairman of the board of Continental Telephone Corp. Let me assure you I do not take offense at the fact my name is incorrectly spelled on the instrument before me.

I appreciate this opportunity to participate in today's hearings. Since 1975, I have been speaking out, before Congress and elsewhere, on the need for legislation to establish a national telecommunications policy on issues that grow more pressing every year.

It was therefore most gratifying, Mr. Chairman, to note the care and diligence with which you, your subcommittee colleagues, and your hard-working staff sought a wide range of views in last year's hearings, and shortly thereafter produced the comprehensive bill under consideration today.

I understand that a new draft of H.R. 5158 is under preparation. If that draft eliminates the concerns and incorporates the suggestions that I express today, I would certainly be pleased to support it. I am encouraged to believe that your new proposal does this to a large degree.

While you were at work, the Department of Justice was going forward with the A.T. & T. antitrust lawsuit. The proposed settlement of that case unquestionably raises as many issues as it resolves. If the telecommunications industry is to be successfully deregulated and restructured, Congress must address those issues.

I turn now to what I believe are the key legislative points necessary to assure the maintenance of quality telecommunications in the United States.

Point 1: Continental and other independents must be allowed a reasonable transition period in which to shift their revenue requirements from interstate to local rates.

This isn't simply a problem, and it isn't an easy problem, but it is critical. Without an orderly transition to a restructured industry, you must accept it as a fact that Continental Telephone and other similarly situated independents will not be able to maintain their high standards of service.

If all of the elements affecting rates that are currently under debate—such as changes in cost allocations, customer premise equipment, inside wiring, and so forth, are transferred in one "flash cut," the resultant upward pressure on local revenue requirements would be extremely oppressive.

If I hear Mr. Henson right, he believes it will be sometime before the effect is evidenced. That isn't my position, because I believe the effect will be immediate and extremely onerous.

The critical transition period for Continental will be the next 5 to 10 years. We need that much time, at a minimum, to shift all of the various elements now under debate from interstate to local rates.

Point 2: Continental and other independents need a reasonable transition period in which to recover their currently invested capital in toll-switching facilities.

If A.T. & T. builds its own trunklines in order to bypass our toll-switching installations, we will be forced to write off this equipment with no recovery from the ratepayers.

To prevent this burdensome loss, we need a carefully focused legislative requirement that A.T. & T., for a limited period of time, utilize the independents' class 3 and 4 toll-switching installations to connect with the local exchange. This requirement would apply, of course, only where such installations are now in place and are adequate to do the job.

Point 3: Charges for the right to access local telephone company facilities should be regulated by the States under a federally established methodology.

I am concerned that, without legislative safeguards, access charges will be seized upon as a political tool to keep local rates unrealistically low. The danger is that sharply increased access charges will force intercity carriers to bypass the local exchange and go directly to their customers. That, in turn, will put increased pressure on local rates.

The most effective way to deal with this potential problem is to authorize the States to fix access charges—but in each instance to follow a methodology or formula established at the Federal level. This will not only assure a uniform approach, but will give State authorities flexibility to recognize the different factors that affect access charges in various local situations.

Point 4: To protect against anticompetitive practices by A.T. & T. in a deregulated industry, at least two legislative safeguards are necessary:

First, A.T. & T. should be prohibited from providing any local distribution service, including cellular mobile or cable television service; second, A.T. & T. should be initially structured so that it cannot use revenues from intercity distribution services to subsidize its other businesses.

The need for these safeguards is addressed more fully in my written statement. Let me just say here that without such safeguards, at least for a reasonable period of time, the objectives of a deregulated industry won't be realized.

Point 5: During a reasonable transition period, A.T. & T. should be required to provide independent telephone companies serving rural communities with the same quality of interexchange service that it provides to larger metropolitan areas.

The objective of this requirement is to assure that there will be a "carrier of last resort" to continue providing intercity service to rural subscribers who want it and are willing to pay a fair price for it. My statement suggests the ways in which this requirement can be implemented.

Point 6: The restructured industry must retain a mechanism for centralized planning, at least of a core network, with full participation by the independent telephone companies.

My statement addresses this point in some detail. For now, I would merely emphasize that deregulation of the industry will not immediately eliminate the facilities of the core network over which the bulk of our telephone service is provided. Therefore, at least for the foreseeable future, the need for this essential planning function will remain.

Point 7: If intercity carriers are required to pay surcharges in addition to access fees, the regulation of those surcharges should be placed under State jurisdiction authority.

I am seriously concerned about the possible creation of a new Federal bureaucracy to impose, collect and disburse access surcharges designed to compensate local companies whose operational costs exceed the national average.

I question the need for any such surcharge in the first place. But my principal concern is that bureaucratic inefficiencies inherent in the Federal administration of these funds will cancel any anticipated benefits. If the purpose of this legislation is the promotion of competition in our industry, we need less government involvement, not more.

If you decide, however, that pooled access surcharges are necessary, I strongly urge that State authorities be given jurisdiction to regulate and administer them. State authorities are closer to the situation and, given sufficient flexibility, can respond more rapidly and more effectively to the rural companies' needs.

Mr. Chairman, thank you again for the privilege of appearing and testifying before you today. I look forward to answering any questions you may have.

[Testimony resumes on p. 756.]

[Mr. Wohlstetter's prepared statement follows:]

Statement of
CHARLES WOHLSTETTER
on behalf of
CONTINENTAL TELEPHONE COMPANY

Mr. Chairman, members of the Subcommittee, I am Charles Wohlstetter, Chairman of the Board and Chief Executive Officer of Continental Telephone Corporation. Continental is the third largest of the independent telephone companies, serving over 2 million subscribers in 36 states from New York to California. Almost all of our customers live in rural areas; the largest city in our system is Manassas, Virginia, which had a 1980 population of about 55,000 people.

While "plain old telephone service" still constitutes our largest revenue source, in recent years we have entered other areas, each of which is highly competitive. These include the marketing of business systems and other terminal equipment, and the provision of network services (including satellite data channels), software information services, and an international consulting and contracting service.

I appreciate this opportunity to participate in today's hearings. Since 1975 I have been speaking out, before Congress and elsewhere, on the need for legislation to establish a national telecommunications policy on issues that grow more pressing every year. It was therefore most gratifying, Mr. Chairman, to note the care and diligence with which you, your Subcommittee colleagues, and your hard-working staff sought a wide range of views in hearings last year and shortly thereafter produced the comprehensive bill under consideration today.

I understand that a new draft of H.R. 5158 is under preparation. If that draft eliminates the concerns and incorporates the suggestions that I express today, I would certainly be pleased to support it. I am encouraged to believe that your new proposal does this to a large degree. I congratulate and thank all of you for putting this bill on the table, and for undertaking to push for the adoption of legislation at this session of Congress.

While you were at work, the Department of Justice was going forward with the AT&T antitrust lawsuit. The proposed settlement of that case, centering on the divestiture of the Bell Operating Companies (BOC's) under a modified 1956 Consent Decree, gives rise to at least as many issues as it resolves. If the telecommunications industry is to be deregulated and restructured, Congress must address those issues and provide legislative guidance on the host of new problems created. Guidance from Congress is absolutely essential if our industry is to use the dramatic technological advances of the last decade to serve the public most effectively in the years ahead. In my opinion, the need for far-sighted, comprehensive revision of Title II of the Communications Act of 1934 is now greater than ever before.

First, let me briefly address the proposed settlement of the AT&T antitrust lawsuit. I have no basic problem with the divestiture of the BOC's if it is accompanied by appropriate legislative safeguards. For better or for worse, the divestiture is consistent with the federal government's long-standing view that local distribution systems are the only natural monopoly markets within the telecommunications industry. Under that theory, companies serving those markets should be structurally separate from companies operating in areas where competition can bring better service. While I still have serious concerns about some of the consequences of deregulation, I recognize as a practical matter that this is no time to urge that the clock be turned back. What we need now are assurances that the industry, as restructured under the modified Consent Decree, will actually provide the benefits sought. Only carefully drawn legislation can provide those assurances.

I turn now to what I believe are the key legislative objectives necessary to assure the maintenance of quality telecommunications service in the United States. Where possible, in connection with a specific objective, I have sketched a broad outline of the legislative guidance needed. Where I am uncertain of the solution, I have at least tried to identify the problem clearly. In all cases, I pledge the full cooperation of Continental Telephone in finding the right legislative path.

1. Continental and other Independents must be allowed a reasonable transition period in which to shift their revenue requirements from interstate to local rates.

This isn't a simple problem but it is critical. Without an orderly transition to a restructured industry, you must accept it as a fact that Continental Telephone and other similarly situated Independents will not be able to maintain the high standards of service that have been the hallmark of these companies over the years. Not only the Independents, but the newly divested BOC's as well, need a reasonable period of time to adjust to an environment in which AT&T will be essentially deregulated. If all of the elements affecting rates that are currently under debate--such as changes in cost allocations, customer premise equipment, inside wiring, etc.--are transferred in one "flash cut", the resultant upward pressure on local revenue requirements would be extremely oppressive.

To illustrate the pressure Continental and the other Independents are already under, let me give you one example of the revenue drain that will occur at an even greater rate in a restructured industry.

Intercity carriers are now able to serve customers directly, using neither the local nor the toll facilities of Continental or other independent companies. In the rural areas served by Continental, several large customers such as manufacturing plants, wholesale distribution offices, and military installations in many instances contribute a significant portion of the local company's total revenues. As more and more of these large users take service directly from AT&T and other intercity carriers, the burden on the local company's remaining users grows even greater. This is because most local company costs are fixed and cannot be reduced at a pace to match the revenue losses that occur in this manner.

To prevent this, and to enable us to accommodate our operations to the new way of life under the modified Consent Decree, Continental, its customers, and other similarly situated Independents will need time to gradually absorb these changes. The critical transition period for us will be the next 5-10 years. We need that much time, at a minimum, to shift all of the various elements now under debate from interstate to local rates. Only with an orderly transition of this kind can our subscribers anticipate continuation of the high quality service they now enjoy.

2. To allow Continental and other Independents a reasonable transition period in which to recover their currently invested capital in toll switching facilities, AT&T should be required, during the transition period, to utilize the Independents' existing toll switching plant to complete message toll calls.

Continental is now depreciating its plant, system-wide, at the rate of 6.7% per year. This means that our plant, on the average, has been assigned a 14-15 year useful life.

Toll switching installations and associated equipment are an important part of the plant that Continental now uses in providing toll calls. If AT&T builds its own trunk lines in order to by-pass our toll switching installations, we will be forced to write off this equipment with no recovery from the ratepayers.

To prevent this burdensome loss, we need a carefully focused legislative requirement that AT&T, for a limited period of time, utilize the Independents' class 3 and 4 toll switching installations to connect with the local exchange. This requirement would apply, of course, only where such installations are now in place and are adequate to do the job.

Implementation of this requirement will perhaps will be difficult. Other avenues may be worth exploring. But we must find some way to prevent the huge losses that an abrupt write off of this equipment would entail.

3. Charges paid by AT&T and other intercity service carriers for the right to access local telephone company facilities should be regulated by the states under a federally established methodology.

Another type of "by-pass" problem is the possibility of access charges becoming so high that intercity carriers, including the newly constituted AT&T, are encouraged not to enter the local exchange. I am concerned that, without legislative safeguards, access charges will be seized upon as a political tool to keep local rates unrealistically low. The danger is that sharply increased access charges will force intercity carriers to by-pass the local exchange and go directly to their customers. That, in turn, will put increased pressure on local rates to meet continuing revenue requirements that cannot be reduced fast enough to match the drain on toll revenues.

The most effective way to deal with this potential problem is to authorize the states to fix the charges imposed on intercity carriers for access to the local exchange -- but in each instance to follow a methodology or formula established at the federal level. This will not only assure a uniform approach, but will give state authorities flexibility to recognize the variety of local factors relevant to the determination of a fair access charge in a given situation. Only this kind of flexible application of a uniform standard will enable Continental, the other Independents, and their subscribers to weather successfully the rocky transition to a restructured industry.

4. To protect against anticompetitive practices by AT&T in a deregulated industry, AT&T should be:

    (a) prohibited from providing any local distribution service, including cellular mobile or cable television service; and

    (b) initially structured so that it cannot use revenues from its intercity distribution service to subsidize other businesses in which it may engage

AT&T will begin its post-consent decree operations as the recipient of about 95% of the industry's total intercity revenues. If AT&T is allowed to provide local distribution service, AT&T will inevitably become the cellular mobile company in many local markets, and the essential effects of the antitrust lawsuit will have been lost.

For the same reason, AT&T should be restricted by some appropriate means from using its monopoly share of the intercity service revenues to subsidize its other businesses. Unless this is done, new competitors could be stifled by the overwhelming advantage that AT&T's other businesses will derive from their association with the dominant intercity carrier. The most feasible means of protecting against this power to cross-subsidize is the separate subsidiary approach generally endorsed by your proposed legislation and the already-approved Senate bill, S. 898, coupled with continuing FCC regulation of AT&T's intercity service for some period of time.

I am not at all wedded to the notion that such restrictions on AT&T must be permanent. It may be that, in time, competition will erode AT&T's dominant position to the point where it is reasonable to allow AT&T to enter local distribution markets and to remove any restrictions originally designed to prevent cross-subsidies. Until that time, however, some restrictions of this kind are necessary to achieve the objectives of a deregulated industry.

5. During a reasonable transition period, AT&T should be required to provide independent telephone companies serving rural communities with the same quality of interexchange service that it provides to larger metropolitan areas.

The objective of requiring AT&T to provide continued high-quality interexchange service to the rural areas served by Continental and other Independents is to assure, at least during a reasonable transition period, that there will be a "carrier of last resort" to provide such service to rural subscribers who want it and are willing to pay a fair price for it.

Since the inception of telephone service in this country, universal service has been the primary goal of the industry and of federal and state regulators and policy makers. An important feature of such universal service is the availability of high-quality, reliable intercity service to both rural and urban areas. Whatever the industry's shortcomings may be, we have, for all practical purposes, achieved that goal of universal service. We should not now let that achievement be diminished.

Presumably, local telephone companies in the restructured industry will be required to remain carriers of last resort -- that is, to offer local exchange service to subscribers in low density areas at a fair price. Legislation should similarly require that AT&T continue adequate levels of service to rural telephone company exchanges, including necessary maintenance and sufficient lines to handle traffic growth. By preserving the concept of intercity carriers of last resort, modified as necessary to fit the new environment, the Congress will also have taken reasonable steps to maintain the universal service we all worked so long and so hard to achieve.

6. The restructured industry must retain a mechanism for centralized planning, at least of a core network, with full participation by the Independent telephone companies.

Since the inception of intercity telephone service in the United States, when a rudimentary switched telephone network was first put into place, the need for centralized network planning has been clearly recognized. This function has included not only the formulation of projected equipment needs and service demands, but also the development of plans for network design and for coordination of network elements into a smoothly functioning, fully interconnected system. Network planning was viewed as essential to assure reliable performance at all times, including periods of national emergency.

Deregulation of the industry will not eliminate, at least for the foreseeable future, the facilities of the core network over which the bulk of our telephone service will be provided. The need for centralized planning, at least of that core network, will thus remain.

The need for reliable end-to-end service will also survive in a restructured industry. Because no single entity will have overall end-to-end service responsibility, core network planning will perhaps be more important during the transition period than ever before. To assure the continuation of high caliber end-to-end service during this period, it is essential that there be a mechanism for the exchange of information and for the implementation of network planning decisions. For this planning to be effective, all telephone companies, including the Independents, must be adequately represented. In a deregulated market, legislation is necessary to provide the framework on which a network planning mechanism can be built.

7. If intercity carriers are required to pay surcharges in addition to access fees, the regulation of those surcharges should be placed under state jurisdictional authority.

I am seriously concerned about the possible creation of a new federal bureaucracy to administer the imposition, collection and disbursement of access surcharges. These surcharges, as I understand it, would be designed to compensate local companies whose operational costs exceed the national average. While I question the need for any such surcharge in the first place, my principal concern is that the bureaucratic inefficiencies inherent in the federal administration of the funds thereby created would negate any anticipated benefits. If the purpose of this legislation is the promotion and development of competition in our industry, we need less government involvement, not more.

If you decide, however, that pooled access surcharges are necessary to compensate rural companies with higher than average costs, I strongly urge that state authorities be given jurisdiction to regulate and administer them. State authorities are closer to the situation and, given sufficient flexibility, can respond more rapidly and more effectively to the rural companies' needs.

* * *

In closing, Mr. Chairman, I would add only one thought. In twenty years with Continental Telephone my experience has been that local telephone companies perform best when legislation or regulations require them to answer only to one master. When they are caught between conflicting requirements of both federal and state authorities, efficiency declines. I know it isn't easy for lawmakers to determine proper boundaries between state and federal jurisdictions, but I urge you to try. My own view is that those boundaries should be drawn so as to limit the jurisdiction of the FCC to those areas where the national interest is clearly paramount and where the FCC's expertise is clearly superior.

Thank you again for the privilege of appearing and testifying before you today.

Mr. **Wirth**. Thank you, Mr. Wohlstetter.

Mr. Reuss.

STATEMENT OF ROBERT P. REUSS

Mr. **Reuss**. Thank you, Mr. Chairman. Mr. Wohlstetter had a little problem with his name, but I want to congratulate you in pronouncing mine right, particularly since your distinguished colleague from Milwaukee has a problem in pronouncing the same surname at times.

My oral testimony will deviate somewhat from my written, in the interest of time, because I don't want to go over all of the points that have been made here.

Briefly, I agree with the points made, that the Justice Department and A.T. & T. should not set the national communications policy. Also, that we feel the independents have been ignored and that deregulation is not the complete solution, and that a realistic transition is necessary.

We appreciate the chance to express our support for your efforts in drafting a bill to deal with the problems of our industry. Let me deal just briefly with about five points.

First, we feel that legislation should clear up the matter that Mr. Wohlstetter has raised as to whether there is a supplier of last resort in the intercity market. Is there any one entity or any one group or any one corporation that is going to be responsible for anywhere to anywhere service?

If so, is it the dominant carrier, A.T. & T.? If it is A.T. & T., then we have to clear up the status of the almost $2 billion investment that independents have in toll-switching equipment and in intertoll investment. The intertoll investment is now an integral part of the nationwide network that does permit anywhere to anywhere service.

Will the dominant carrier, if it is the supplier of last resort, have the obligation to support and use this plant?

Or do they have the option to bypass it? If there is no supplier of last resort, then what is the status of our investment? Is it to be deregulated? Is it to be unsupported by a national risk pool? Is it to be treated like an OCC? What is the future here? Who has the responsibility for numbering plan service? Who has the responsibility for toll information? Frankly, at this point, I don't really know whether further money in the intercity investment is a good or bad deal for our shareowners and for the future of our company.

What is needed is continued economic integration of the nationwide toll network. I am talking integration, not of local with toll, but of the intercity service. We need, as has been pointed out here, a joint planning process, a realistic transition period. And as Mr. Brophy has pointed out, flexibility in capital recovery that makes sense in a competitive area with rapidly changing technology.

As Mr. Wohlstetter has pointed out, this must apply to existing toll switching and intertoll transmission facilities. The second point, what about the terminal market? Under a fully competitive terminal market, shouldn't the telephone companies be completely relieved of any obligation to serve?

Our own company has been working for 4 years to move away from providing customer premise equipment under tariff. As a result, we have reduced our terminal equipment capital requirements by close to $100 million, which is a lot of money for a company our size. And any legislation which would permit the States to reregulate customer premise equipment would not be in the best interest of the telephone companies and would saddle them with an oddball business, in our view.

Certainly, the electric power industry has no obligation to provide wiring or appliances. Also, I think we should speed up as rapidly as possible the capital recovery process on terminal equipment. Third, I think we should set up a clear legislative mandate to encourage local measured service, and preempt the States in any effort to block up service.

If the telephone companies are to handle the transition on an orderly basis, this is essential. The marginal user will benefit from lower rates, and the heavier user can be assessed more equitably. Fourthly, it is extremely important that legislative solutions to meet the concern about the dominant position of the Bell System not be permitted to restrain the legitimate activities of independent telephone companies in pursuing competitive communications markets.

As I understand it, the basic theory of the Western Electric and A.T. & T. Co. was that as a rate base, rate of return regulated monopoly, A.T. & T. had incentive and the ability to leverage the power it enjoys in the regulated monopoly markets to foreclose and impede the development of competition in related potentially competitive markets.

It is very difficult for us to see how such a theory can be used to rationalize any restrictions on the independent telephone companies in competing in the new marketplace in the communications industry.

Adequate structural and accounting controls are in place. And in the case of CENTEL, we have been audited and reviewed many times because of our involvement in regulated communications activities. And we have satisfactorily passed the tests with respect to these accounting controls, at least at the State level, to insure that the regulated customers are not being overcharged to support competitive activities.

The health of the independent telephone companies, with their heavy local distribution investment, has been a worry to the investment community. I just recently returned in the last 2 days from meetings with investors and analysts. And this is a worry.

The concern has been about this subsidization of the nonregulated activities by the regulated. But I am wondering as we look ahead if the concern shouldn't be in the other direction. I am glad to see that H.R. 5158 recognizes this and that cross-subsidization is not permitted in either direction.

A final point, and this may seem a little bit unusual, but we believe legislation should recognize the onward thrust of new technology and should permit at some time, when appropriate, the deregulation of the local exchange service.

Mr. Chairman, we appreciate the opportunity to give this brief summary of our position and would also like to have the opportuni-

ty to file supplementary comments and work with your staff
Thank you very much.

[Mr. Reuss' prepared statement follows:]

ROBERT P. REUSS,

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

OF

CENTRAL TELEPHONE & UTILITIES CORPORATION
(CENTEL)

Chairman Wirth and Subcommittee members, I appreciate this opportunity for Centel to present its views on the issues of national communications policy which you are addressing.

Centel's operations span a wide spectrum of communications-related activities. We provide telephone service to over 1 million customers in ten states. We are one of the nation's largest sellers of business communications systems. We provide cable television and master antenna service to over 120,000 customers. We also sell certain proprietary communications-related products and a broad range of supplies to affiliated and unaffiliated communications companies. In addition we operate electric properties in Kansas and Colorado.

We want to discuss the four issues we find most significant at this time. While most of the people appearing before you have concentrated on the nature of the AT&T settlement, the issues that we want to discuss are only indirectly related to that settlement.

In sum, these issues relate to: first, the fragmentation of the telephone market we've been used to; second, the future health of the nationwide telephone network; third, the future role that independent telephone companies and their facilities can play in this industry; and fourth, the effect that this change will have on our customers' phone bills. Lastly, we want to outline some potentially radical ideas for you to consider.

What used to be viewed as a single telephone marketplace is no more. It is now at least three distinct types of markets - the long distance market, the local exchange market, and the market made up of telephone instruments and inside wiring. Over the past decade, competition and technology have sliced through our industry like a knife, cutting it permanently into these pieces.

In the first market, the long distance market, we have to learn new rules - even though we are still using some of the same equipment on the same playing field. Centel has almost $70 million invested in intercity facilities, an investment made when cooperation in improving nationwide service was rewarded. The changing rules may make our investment obsolete as well as the investment of many local telephone companies like ours. Even worse, the new rules may eliminate the incentive to improve overall telephone service.

More and more frequently, carriers and major U.S. corporations now are bypassing the existing network with private facilities. Our own intercity investment thus begins to look a little uncertain. How can we recover that investment if technology causes people to choose not to use those facilities? It will be difficult. We'd certainly think twice now before increasing that intercity investment.

Should someone be "on the hook" to maintain and improve the nationwide network? We say "on the hook" because that responsibility necessarily includes an obligation to serve the public as a carrier of last resort, regardless of the bottom line economics. We would not want to be in a position where we had to offer telephone service anywhere, but at the same time were unable to pay for it except out of our own pocket - because it was not competitive. We don't think we'd be in business long without some offsetting rights and privileges. Economic integration used to be one. Very soon, it will not be. Then we'll all have to worry about our level of service and the overall health of our telephone network.

We don't know yet what will eventually happen to Centel's intercity investment. Without some form of joint activity or some certainty about how the market will operate, the risks will be high that that investment quickly will be ignored or underutilized.

One of the advantages for the public in this business has always been the great spirit of cooperation in network planning. The incentive to cooperate was there. It may no longer be there. Every investment decision will have to carry a direct and immediate financial payback. In the end, the overall network can be hurt. One obvious issue is the coordination of the nationwide numbering plan.

Let's consider that second market - the local exchange market. Even now, there is an eroding natural monopoly. Private carriers and large corporations now not only bypass toll facilities, they bypass the local exchange itself with regularity, taking with them revenue dollars that helped keep local rates at their previous low levels. The costs of the local network must be borne by fewer people. We all know what that means - upward rate pressure. This last bastion of traditional natural monopoly service itself may have a short future.

One way to deal with this change in the local exchange is to encourage local measured service, where rates are based on the cost of access plus usage. In the past, consumer groups have feared usage-based pricing. Yet, many residential customers will be better off with local measured service than with traditional flat rate local service pricing. Usage based pricing is not anywhere near as threatening as some people make it out to be. Rather than being politically dangerous, it can be politically beneficial.

Local measured service can actually help limit rate increases for the low and moderate user. It also can accommodate a legitimate form of life-line service for those who need it. It should be considered.

Lastly, let's look at the terminal equipment market. We've had experience selling terminal equipment for many years now. It is a key to Centel's own future. This market, too, is not like it used to be. If we're going to deregulate this market, let's do it once and for all. Dispense with bifurcation and other artificial restrictions. Give everyone in this market the space that they'd have in any other competitive marketplace. Let's acknowledge the inevitable balloon in local rates that realistic capital recovery and competitive pricing for terminal equipment require, and get past it, so this market can become a normal competitive one for everyone.

What can our telephone companies expect from the new era? We look at the new Consent Decree and wonder how the Bell System operating companies will fare if they are relegated solely to local exchange service. They will be structured very much like the independents, but their opportunities will be more limited. We are worried about the shadow effect of the new Consent Decree. While the size of AT&T may have dictated that result, similar restrictions on all local telephone companies may condemn them to long term financial problems. We need to use new technologies and we need access to new business opportunities.

Centel's business strategies have been developed after a long look at what is happening to our industry. We'd really have problems if we couldn't participate in activities other than local exchange service.

Let me leave you with a few thoughts about the future. They may seem a bit radical now but I guarantee you they won't be in the near future.

Assuming that the long distance market and the terminal equipment market are becoming increasingly competitive, can competition in the local exchange market be far behind? Even now, that is occurring. Cellular radio technology, broadband and digital termination services are developing substitutes for local service. When that competition emerges, you'll be faced with even greater rate problems, and inevitably you'll have to consider deregulation of all or part of local exchange service too! That idea is not so far away as you think.

To facilitate the changes we anticipate let's look at that continual tug-o-war between the federal and state jurisdictions. Almost everyone will agree that there is a strange boundary between what the FCC can do and what the state commissions can do, and that it impedes speedy resolution of many of the issues we all face. Someone has to suggest a method to resolve it. So we will.

In your bill, permit federal preemption of the entire industry whenever the issues warrant it. We say "permit" - not "require." A unified approach to the changes in our industry is often necessary. There are issues that demand one response. We are not saying that we should take away the role of our state commissions. Our telephone companies get along quite well with them and the FCC can't assume their role anyway. State commission knowledge and expertise is essential. We are saying that when problems are confronted, the federal-state boundary should be simple and clear. Jurisdictional questions can't be allowed to be in the way of the real issue - the health of our business, and this is the only way we know to do it.

In conclusion, Mr. Chairman, we agree with you that a national telecommunications policy is essential. The longer we wait for a bill that deals with the overall changes in our industry, the greater the threat to the long term viability of our telephone companies. Legislation should look to last well into the next century. Foresight and flexibility must be built into any bill. Overly specific provisions, artificial market distinctions and temporary patches are not the answer for the industry. We need both flexibility and opportunity.

Thank you again for this opportunity to address you. I'd be pleased to answer your questions.

Mr. WIRTH. Thank you, Mr. Reuss.

As noted earlier, your full testimony will be in the record and the record will remain open for supplementary comments and reactions, particularly as we get out the revised technical amendments.

Mr. Lumpkin.

STATEMENT OF RICHARD A. LUMPKIN

Mr. LUMPKIN. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am Richard A. Lumpkin, president and chief operating officer of Illinois Consolidated Telephone Co., Mattoon, Ill. I am here as president of the U.S. Independent Telephone Association.

My statement will echo much of the presentations you have already heard.

USITA feels any legislation adopted by Congress should include competition and deregulation as important goals. However, first it must assure that this new approach does not weaken nor destroy the solid foundation of universal basic service now provided by telephone companies, independent and Bell.

Our industry is a national resource essential to commerce, to our Nation's economic well-being, and vital to our country's national defense and emergency preparedness. Technology has added its competitive pressures. FCC rulings have stretched the 1934 Communications Act beyond its limits. Now there is the Bell System restructuring.

It is Congress role to legislate national telecommunications policy. This association has been urging legislation for the last half-dozen years because stability must be returned to our industry. Independent telephone companies must regain the ability to plan for the evergrowing needs of their customers with a greater degree of certainly. They must know what their relationship will be with each other and with all the other carriers.

My written testimony submitted for the record and these few remarks are limited to broad observations regarding policy issues USITA feels Congress should resolve. We have already discussed specific suggestions on H.R. 5158 with the staff.

One concept is fundamental. Legislation must insure that everyone, everywhere will be provided with basic telecommunications service. Regulators should be charged right up front with insuring universal regulated basic service at reasonable charges.

Universal service cannot survive in a totally competitive marketplace. There would be no service in many areas where there is no profit opportunity.

The telephone companies must now serve everyone. To insure future universal basic service, it seems inevitable that we who built and own the telephone network will continue, under regulation, to be required to serve.

But adopting universal basic service as a legislative policy goal means legislation must also be realistic and provide the means to attain that goal. Universal service depends upon the availability, planning, building, and maintaining of the integrated switched telephone network. It depends upon the ability of the many companies which have the common obligation to serve, to deal with each other freely.

They must plan and manage all of the technical aspects of providing service to everyone, everywhere, using, as needed, facilities of any telephone companies. Legislation should explicitly provide for a process to coordinate effective network planning and management.

Also, legislative realism requires certain economic relationships. We cannot be required to serve where others will not if our rate averaging and division of revenue concepts are destroyed.

Surely reliance on access charges will modify the current practice. However, whenever there is joint through service provided by more than one carrier, some form of revenue division will need to exist among the participants.

Legislation must permit joint through service, appropriate tariffs, and division of the revenues among those providing the service.

It seems agreed that separations and settlements will be modified and we will have access charges. It is not agreed how they are to be determined nor how they are to be collected by the telephone companies. USITA believes that all carriers accessing exchange areas directly or indirectly should share in supporting the costs of the local distribution.

We do not agree that either the formulas or procedures for division of revenues should be legislative goals. Regulators should be charged with insuring an equitable result but retain sufficient flexibility to meet changing circumstances.

We support the need for pooling of both costs and revenues of access charges on a national basis, to allow averaging, sharing of risks, and to achieve as much rate uniformity as possible.

The FCC's role should be brought up to date. USITA supports the thrust of the second computer inquiry, but we are concerned over the Commission's legal authority to accomplish what it tried to do.

At best, the door has opened for extensive judicial review. The uncertainty which already exists in our industry has been perpetuated.

Clarifying the FCC's authority does not mean increasing the scope of FCC regulation of independent telephone companies. Few independent telephone operations are directly regulated by the FCC under the 1934 Communications Act, but any activities in joint interstate operations are under FCC authority.

Congress should explicitly insure that the FCC has authority over the network functions necessary to provide universal interexchange basic service; equitable interconnection with the network by all carriers; and setting of charges for accessing exchange areas.

We urge the subcommittee to remove any legislative language indicating that independent telephone companies are to be directly regulated by the FCC.

Once Congress provides for regulated basic service, independent telephone companies should not be saddled with additional Federal or local regulation of their competitive activities. Unregulated revenue should not be imputed to the rate base for tariffed services. Independent telephone companies should be allowed to use any existing, new or yet to be developed technology in the provision of services.

The FCC's CATV cross-ownership rule should not be perpetuated in this legislation.

The Justice/A.T. & T. settlement of the antitrust case is bound to have an impact on the way independent telephone companies do business.

Nevertheless, if universal service is to survive through an up-to-date integrated regulated network, a relationship between A.T. & T., Bell operating companies, and independents must continue. The efficiency of the network will be driven by the participants in the partnership, however modified.

We want to continue to participate in the relationship necessary for universal service. However, we do not want to lose our identity as independent telephone companies. Independents are not part of the proposed consent decree and are not directly affected by it. We don't want to be affected even indirectly.

Independent telephone companies should be free to chart their own futures and not directed into channels about which they have had no say and over which they have no control.

In the name of competition, legislation should not handicap us in the race for the opportunities the competitive deregulated marketplace may offer.

We need a bright line drawn between the services and facilities independent companies must provide under regulation and the products and services we may choose to provide without regulatory oversight or interference.

We support the need for legislation as we have in the past. Congress will finally resolve the policy issues we face for it must bring sense and order to an uncertain but essential telecommunications industry.

We offer the full cooperation of the association and its members to achieve that result.

Thank you very much.

[Testimony resumes on p. 785.]

[Mr. Lumpkin's prepared statement follows:]

TESTIMONY OF RICHARD A. LUMPKIN
ON BEHALF OF
THE U.S. INDEPENDENT TELEPHONE ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
FEBRUARY 18, 1982

Mr. Chairman and members of the Subcommittee, I am Richard A. Lumpkin, President and Chief Operating Officer of Illinois Consolidated Telephone Company, Mattoon Illinois. I am appearing before you today on behalf of the U.S. Independent Telephone Association as the current President of that organization.

My purpose is to tell the Subcommittee about the nature of USITA, briefly describe my own company and the scope of its operations and to outline very fundamental legislative concepts supported by USITA which we feel must be addressed.

USITA's representation of Independent telephone companies dates back to 1897. The Association's objectives include helping its members improve service and negotiating with the Bell System on a wide range of issues. These include division of revenues for jointly provided services and essential issues affecting how the network functions such as equipment compatability and network management concerns.

Independent telephone companies, now almost 1500 in number, provide service to about 36 million telephones in over half of the geographic area of the United States having telephone service. Our members are neither owned nor controlled by AT&T. Independents have current annual revenues near $12 billion about 1/2 of which is derived from toll; we have approximately $39 billion invested in facilities and equipment; we provide employment for 190 thousand people. Over a million shareholders have stock in Independent telephone companies which are publicly held. These statistics affirm that Independent telephone companies are a very important part of our nation's economy and are an economic stabilizing force in the communities which we serve.

Nevertheless, we are not quite 20% of the telephone industry in the United States. Because the Bell Operating Companies and AT&T are more than 80% of the total industry, Independent telephone companies will be affected significantly by events which will dramatically change the structure of the Bell System.

Obviously, we are not the same as the Bell system, but Independent telephone companies are also not the same as each other. Hence their needs and objectives do not always coincide. This Subcommittee has heard or will hear from a number of Independent telephone company executives--officers of the largest companies as well as some of the smaller ones. You will hear a diversity of viewpoints. But in addition to the diversity, I believe that you also will hear a great deal that Independent telephone companies have in common with each other and with the Bell System companies as well. Most of these witnesses represent companies which are USITA members.

My own company, located in central Illinois, is neither like the large holding companies nor the very small rural telephone companies. Among the Independents, we are about 14th in size and 16th in revenues, we serve over 125 thousand telephones in 18 contiguous counties with 37 exchanges. We own and operate three toll switching centers which interconnect our exchanges and the exchanges of five other telephone companies with each other and with the nationwide toll network.

Independent telephone people like to say that they do more than simply serve a community; they are part of the communities where they are located. I feel most strongly because Illinois Consolidated is a Lumpkin family business. I am the fourth generation to serve as its President. My father, at age 84, is still active in management of the company as Chairman of its Board of Directors. He and I follow in the line of his father and his father's father, the founder of the original company in 1894.

Perhaps some of what I say will be flavored by my own personal experience and heritage, but it will also reflect the positions and policies adopted by this Association's Board of Directors. My reason for highlighting the type of company which I manage is to emphasize that my feelings regarding the telephone industry are not abstract. My concerns run very deep. I know our communities and industry will continue to grow and prosper if we remain dedicated to providing the highest quality of service possible.

I believe service comes first. Thus, I am unable to view the current and future status of telecommunications as simply a competitive business opportunity. Opportunities may be available but we will not serve America best through a purely entrepreneurial approach to the provision of telecommunications. Congress should not force us into such a mold. I trust that any legislation adopted by the Congress will include among its purposes more than the encouragement and promotion of a competitive, deregulated atmosphere for the telephone industry. That should be one goal but first must come the assurance that the new is to be built on the solid foundation of universal basic service now provided by telephone companies--Independent and Bell.

First, it should be made very clear that USITA strongly supports the need for legislation. Our industry is a national resource essential to commerce, to our nation's economic well-being and vital to our country's national defense and emergency preparedness. We have entered a new era as we face the impact of competition and changing technology. The 1934 Communications Act has been stretched by FCC rulings beyond its limits. Our nation's telecommunications policies must be reassessed. Setting those policies is Congress's role and it is what our Association has been urging for the last half dozen years.

I note a growing consensus in all segments of the telecommunications industry that the 1934 Communications Act needs revision. Publicity I have seen indicates that now even the FCC is calling for legislative clarification of its authority to regulate in a changing environment.

USITA knows that stability must be returned to our industry and that legislation is necessary for stability. Independent telephone companies must regain the ability to plan extensive construction and upgrading (with some degree of certainty as to the future) to meet the ever-growing needs of their customers. Huge investments cannot be made by companies without some idea of what their relationship will be with each other and with all the other carriers in or entering the market.

This industry is coping with changes resulting from technology and decisions by the FCC and some state regulatory commissions, but each such modification has increased the need for legislation. Now, add to those pressures the restructuring of the Bell System proposed by AT&T and the Justice Department. It is clear that telecommunications policy issues must be high on the agenda of Congress.

The telephone companies associated with USITA are pleased that this Subcommittee is devoting itself to common carrier legislation and is seeking the views of all who will be affected when legislation is finally adopted.

As the Chairman and the staff know, representatives from this Association and other Independent telephone companies have spent a great deal of time discussing and offering specific suggestions on H.R. 5158 to help find a consensus and provide in that bill for a smooth transition to a marketplace oriented telecommunications business. I will not dwell on specific recommendations we have made or legislative language we have suggested. I would rather offer some broad observations regarding policy issues USITA feels Congress should resolve.

Writing communications legislation is an extremely tedious and complex activity. But the incentive to find solutions comes from a common objective we share with this Subcommittee--how best to serve the public interest.

UNIVERSAL BASIC TELECOMMUNICATIONS SERVICE

I feel one concept is fundamental. Legislation must ensure that everyone, everywhere will be provided with basic telecommunications service. That should be an explicit policy. The regulators should be charged right up front with ensuring universal regulated basic service at reasonable charges.

In my opinion universal service cannot be continued in a totally competitive marketplace. In a purely economic sense it doesn't pay to serve many areas the telephone industry now serves at the prices it charges. In a fully competitive market a logical business decision would result in withdrawing service from areas where there is no profit opportunity

The telephone companies must now serve everyone. To ensure future universal basic service it seems inevitable that we who built and own the telephone network will continue, under regulation, to be required to serve.

When universal basic service is adopted as a legislative policy goal, legislation must be realistic in providing the means to attain that goal. Universal service depends upon the availability, planning, building and maintaining of the integrated, switched telephone network. It depends upon the ability of the many owners of portions of that total network to deal with each other freely to plan and manage all of the technical aspects of providing service to everyone, everywhere intermingling, as needed use of facilities of all companies which have joined in the informal partnership because of their common obligation to serve. Legislation should explicitly provide for a process to coordinate effective planning and network management.

ECONOMIC INCENTIVES

Also, legislative realism requires certain economic relationships. We cannot be required to serve where others will not if our rate averaging and division of revenue concepts are destroyed. Surely sole reliance on access charges will not provide adequate economic incentives. Whenever there is a regulated joint through service provided by more than one carrier, some form of revenue division will need to exist.

It has been the sharing of profits as well as the risks which has encouraged all telephone companies to make investments enhancing the total network rather than limiting their concern only to their individual companies. Legislation must include provisions for joint through service, appropriate tariffs and division of the revenues among those providing the service. Hence, we conclude that

--(1) universal basic service at reasonable rates requires continuation of the integrated switched telephone network.

--(2) insuring a viable network requires technical and management coordination and a common economic incentive among the participants.

The economic incentive to make the network function properly is important. It requires a financial relationship among the carriers which jointly own the network and recognition that piece parts of the network do not stand alone. They are technically integrated--and must be. They now share risks and rewards--that must continue.

But to share financially in the enterprise requires pooling for at least the regulated activity.

Pooling, in a ratemaking and division of revenues sense, is the "glue" that holds the technically integrated nationwide network together. Without assurances that costs will be recovered on a timely basis, investments and other expenditures needed to maintain and improve the basic network will not take place and the network will deteriorate.

Let me use the conversion to seven digit dialing in the late 1940's as an example. Local telephone companies made substantial investments in local switching equipment to accommodate the use of seven digits even though fewer than seven digits were needed for local calling, and even before they could participate in Direct Distance Dialing (DDD). These additional costs were recovered through higher toll rates, rate averaging and the industry's settlements process. The toll users who benefited from DDD paid for the network enhancement. If a "bill and keep" exchange access arrangement had existed then, and if the recovery of this additional investment had to come from each company's own access charges, I'm not sure we would have DDD today.

It seems agreed that separations and settlements will be modified and we will have access charges. It is not agreed how they are to be determined nor how they are to be collected by the telephone companies. USITA believes that all carriers accessing exchange areas directly or indirectly should share in supporting the costs of the local distribution.

We do not agree that either the formulas or how revenues should be divided are legislative goals. The regulators should be charged with ensuring an equitable result but retain sufficient flexibility to meet changing circumstances.

For instance, right now significant by-pass capability is developing. The interexchange usage of the bigger customers can be siphoned off without accessing the local exchange. It may not be possible to set access charges high enough to recover costs on a "bill and keep" basis without causing by-pass to occur.

We support the need for pooling of access charges on a national basis to allow averaging, sharing of risks and to achieve as much rate uniformity as possible.

NETWORK PLANNING

The need to ensure the capability for network management planning seems elementary. Even after the AT&T restructuring takes place, telephone companies, both Bell and Independent together with the interexchange capability of Independents and Long Lines will provide the network everyone, including competitors, will use. These companies will be responsible for regulated basic telecommunications and will be required to provide service to all who make a reasonable request for it even in areas the competitors will avoid. We expect regulatory oversight but there must be freedom for the participants to meet to develop plans and to carry out the day to day coordination of a very complex and interdependent business.

Telephone companies together must be able to plan plant and facility additions needed now or in the immediate future, and to build them and put them into operation on a timely basis integrated with all that exists. It is equally important that long-range planning and coordination continue. Technology must be deployed to fit our needs.

All telephone companies need to participate in planning for a revised national numbering system. We must have the planning capability to meet emergency and disaster needs, localized, regional or even national in scope. We must be able to do such elementary things as insuring troubleshooting and repair of service problems when more than one company is involved.

FCC AUTHORITY

To insure the goal of universal service and network integration , the FCC's role should be brought up to date. In 1980, the Commission made a number of rulings which were truly revolutionary. The one most often mentioned is its ruling in the Second Computer Inquiry. In this Association's filings regarding that ruling, we have taken the position that we do not object to the thrust of the order, but we are concerned over the Commission's legal authority to accomplish what it tried to do.

The Commission has expressed confidence in its jurisdiction but Computer Inquiry II and some other decisions charted new legal territory. At best the door has opened for extensive judicial review. The uncertainty which already exists in our industry has been perpetuated. The members of our Association can live with Computer II but we agree with a recent FCC Task Force recommendation indicating that the FCC position would be strengthened if legislation were enacted clarifying its authority.

SCOPE OF FCC'S AUTHORITY

In clarifying the FCC's authority, Congress must make certain that in the name of competition and deregulation it does not increase the scope of regulation by the FCC over Independent telephone companies. Only a handful of the almost 1500 Independent telephone operations are directly regulated by the FCC under the 1934 Communications Act. To be sure all telephone companies providing joint through services as part of the integrated network are connecting carriers and thus their activities related to interstate operations are under FCC authority. But essentially AT&T is the carrier regulated by the FCC with the Independents falling under most of the same rules and having the same rate of return on joint interstate toll activities.

There is no justification whatsoever for telephone companies which operate almost wholly within a single state to be regulated in Washington, D.C. That is true whether they be a very small company, a very large company, or even if one is affiliated with a holding company. The principal use is local and the public served makes up the local community. State regulators are in a better position to understand and respond to local needs.

We do not suggest that Congress should reduce the authority of the FCC over those activities which are part of the joint offering of basic interexchange universal service. Indeed, the goal of Congress should be to explicitly ensure that the FCC can regulate the network function necessary for providing universal interexchange basic service; that it can ensure equitable interconnection with the network by all carriers; and that the Commission performs its role in connection with the setting of charges for accessing exchange areas.

We urge Congress to remove any legislative language indicating that Independent telephone companies are to be directly regulated by the FCC. The bill should concentrate on explicitly spelling out the FCC's authority over specific matters.

Legislation encouraging competition should not handicap Independent telephone companies' activities, restrain their growth or interfere with their ability to enter the competitive marketplace. Telephone companies will be effective competitors. We will compete in many open markets with each other, with the Bell System and with new entrants into telecommunications. But that will not happen if we must follow a set of rules not required of our competitors.

Once Congress provides for universal basic service at reasonable charges through a regulated integrated network, Independent telephone companies should not be saddled with additional federal or local regulatory restraints on their competitive activities. Revenues from unregulated activities should not be imputed to the rate-base for tariffed services. Independent telephone companies should be allowed to use any existing, new or yet to be developed technology in the provision of services.

UNREASONABLE RESTRICTIONS ON TELEPHONE COMPANIES

We have been restricted in the past by the FCC's CATV cross-ownership rule which precludes all except the very small rural telephone companies from providing cable television services in their own service areas. The cross-ownership rule should not be perpetuated.

The objectives of this legislation are procompetitive and proderegulation. The arbitrary restriction on telephone companies engaging in any activity whenever and wherever they have the opportunity is in direct conflict with these objectives. I speak only on behalf of the Independent telephone companies. AT&T has said it has no desire to engage in the provision of CATV programming.

Since 1976, the legislative process has evolved through a series of bills encouraging the growth of new carriers and the creation of more competition. Our industry seeks no legislated advantage. By the same token, we do not expect to be placed at a disadvantage through legislation.

Also, I should note this legislation addresses common carrier issues. CATV provisions have no place in the bill and should be deleted, leaving the final determination of this issue to the FCC where the ill conceived cross-ownership rule originated

Frankly, USITA's policy is to ask Congress to order the FCC to rescind the cross-ownership rule. I understand that suggestion is politically unfeasible, but I urge this Subcommittee to at least remain neutral, neither for nor against CATV interests and neither for nor against telephone interests on this issue.

The FCC cross-ownership rule is the type of Federal government involvement in local affairs that have the people of this country upset. The will of the FCC, and the weight of the entire Federal Government, if legislation is passed as now written, are imposed on local authorities who really are in the best position to choose who serves their area. The FCC never should have injected itself into this issue. Had it not, many more Americans today would be enjoying cable TV service and have a number of other services available to them.

I believe a strong motivation for the cross-ownership ban was to keep Bell companies out of CATV service. Independents and their customers suffered as a result. I hope that same mistake is not repeated again through the breakup of the Bell system.

Independents should not be foreclosed from any marketplace simply because the Bell Operating Companies or AT&T may be limited. If Bell companies cannot sell terminal equipment the same limitation should not extend to the Independents. We should be allowed to provide any of the enhanced, nonregulated services. We would certainly hope that neither Congress nor the Commission makes a CATV cross-ownership type mistake in dealing with the cellular radio issue. While there may be a competitive marketplace for cellular radio services, that service is very much a part of local exchange service and the local telephone company must be allowed to participate if subscribers are to fully benefit.

IMPACT OF JUSTICE-AT&T SETTLEMENT

It is impossible for me or indeed for USITA to assess the impact of the Justice-AT&T Settlement of the antitrust case. The proposed Modified Consent Decree is a relatively simple document addressing a monumental task. The largest corporation in the world is to be restructured. This was described as an historic event. It certainly created worldwide attention and shock waves are still reverberating in much of the business and communications world. But no part of the industry will be more affected than the Independent telephone companies.

During more than 100 years Independents and AT&T have worked together to build the world's best telephone system. The technology and economics devised under the oversight of regulators and pursuant to the 1934 Communications Act have been the most successful ever developed in the world's history. Now the organization of 80% of the telephone industry is to be taken apart and put back together in a significantly different form.

We have heard the views of Bell and Justice Department officials. We have designated a special task force within USITA to examine the agreement and to follow the reorganization plan as it develops, reporting to our Board of Directors. We are asking that committee for an analysis of the effect on our companies.

Even before that report, I am confident of one thing. If universal service is to survive, if we are to have an up to date integrated regulated network, a relationship between AT&T, Bell Operating Companies and Independents must continue. The efficiency of the network will be driven by the participants even in a modified partnership. We want to continue to participate in the relationship; however, we do not want to lose our identity as Independent telephone companies. We are sure Independent telephone companies are not part of the proposed consent decree and are not directly affected by it. We don't want to be. Independent telephone companies need to determine their own futures and not be directed into channels about which they have had no say and over which they have no control.

Our companies presently own portions, relatively small to be sure, of the interexchange network. That appears to be the comparable portion that will be vested in Long Lines. The Bell Operating Companies will not participate in providing interexchange services. It would make no sense to apply the same idea to the Independent telephone companies. In many cases Independent companies are not large enough to withstand the type of separation that would be required if our activities followed that outlined in the proposed consent decree. Congress should not treat us like AT&T--nor should the FCC or state regulators.

We want to chart our own future. We trust that any legislation will not handicap the opportunities the competitive deregulated marketplace may offer.

SUMMARY

I have touched on some of the important issues USITA believes must be addressed in legislation. We support the need for legislation as we have in the past. Congress will finally resolve the policy issues and will ultimately provide direction to our industry and our regulators for it must bring order to an uncertain but essential telecommunications industry.

Our companies can survive and prosper as a regulated industry. We can also compete and still serve our customers' needs. However, we cannot survive for long under regulated competition. That is the pitfall towards which early FCC rulings seemed to direct us. Legislation must avoid a similar result.

The switched telephone network is indeed one of this nation's greatest assets. It must remain available for all to use. It must be the vehicle to ensure universal basic service at reasonable rates under regulation, but in simply providing portions of that network we should not be regulated beyond the need to serve that role. Having once provided for universal basic service, Independent telephone companies must retain the flexibility to meet competition on equal terms. In the competitive marketplace, we must also have the right to choose to serve or not . . . the right to enter and exit markets . . . the right to succeed or to fail. The regulators need policy guidelines. They need a bright line drawn between the services and facilities Independent companies must provide under regulation and the products and services we choose to provide without regulatory oversight or interference.

USITA has worked with the Subcommittee staff and with the staffs of the Subcommittee members. We desire a final solution to the legislative question and we offer the full cooperation of the Association and its members to achieve that result.

Mr. WIRTH. Thank you very much, Mr. Lumpkin.

Before we get into questions and discussion, I would like to ask if any of you have comments you might like to make on what other members of the panel might have said, additions, clarifications, comments.

Mr. HENSON. Mr. Chairman, I seldom disagree with my colleague, Mr. Wohlstetter. I think he misunderstood what I said. I did not——

Mr. WIRTH. Probably had the wrong guy, so there is no disagreement, right?

Mr. HENSON. The competitive factors that are extant in our industry will indeed cause a local rate effect that is immediate. The consent decree modification has long-term local rate implications. Are we clear, Charles?

Mr. WOHLSTETTER. As usual, Paul, I defer to you.

Mr. WIRTH. Do any of the rest of you have comments? OK. Mr. Tauke.

Mr. TAUKE. Such a friendly group this morning, Mr. Chairman. There are so many things that we could ask. Let me begin with just a few general questions. As I understand this consent decree, we will be having a number of Bell, more than one Bell operating company that is going to be operating under considerably different rules from the rules under which you operate.

Why, if the operating companies are divested from A.T. & T., operate with different rules than you have? Or do you think that perhaps they should be thrown into the same bag, if you will, with the companies you represent?

Mr. REUSS. In the long run, I think they should not operate under different rules. That to confine any corporate entity to a single technology or to simply the local distribution network doesn't make sense. With merging technology, no matter how hard you try to draw the line on a legal basis, it just isn't going to make sense. On the other hand, there may be a period of transition where this kind of containment of their operations might work.

But in the long run, I just don't see it being practical.

Mr. TAUKE. Mr. Wohlstetter.

Mr. WOHLSTETTER. I am not at all certain that I know what these Bell operating companies are going to look like. As a matter of fact, I don't think they know what they are going to look like. And until you have an idea of whether or not they are simply going to be in an office someplace without equipment, or without switching ability, or whatever American Telephone or Mr. Baxter chooses to leave them, they are not related to anything we are at all.

We have such equipment. We have such investment.

Mr. TAUKE. Let me just interrupt you for a minute and say as I understand the consent decree, they are not permitted to have interexchange services; is that correct, comply with your understanding?

Mr. WOHLSTETTER. That is correct.

Mr. TAUKE. You are able and do have interexchange services?

Mr. WOHLSTETTER. That is right.

Mr. TAUKE. Should the consent decree be modified to permit them to have interexchange services?

Mr. WOHLSTETTER. I wouldn't venture to say what the consent decree should do to them, because that is their business. But in the last analysis, I agree with Bob Reuss. Ultimately, telephone companies that perform like services should, except for those unregulated businesses, or those with which we have not dealt today, look and be treated pretty much the same.

But I don't know exactly what kind of—what in their generosity, if you like, or wisdom, American Telephone is going to leave those BOC's.

Mr. TAUKE. Let's set aside the consent decree for a minute, assuming that the legislation that is going to be the controlling factor. I am saying in the legislation, should we be modifying the consent decree and permitting them to have interexchange services? Or other things such as you have?

Mr. WOHLSTETTER. Yes, I think that is fair enough. I think that is in the spirit of competition.

Mr. TAUKE. Mr. Lumpkin, I gather from your testimony that you were not agreeing with that point of view. Did I misinterpret what you were suggesting?

Mr. LUMPKIN. I don't think my testimony really was intended to address that. I was coming at it from the other direction and really saying that, for whatever reason, the consent decree, or Congress may in its judgment impose limitations on the Bell System, that those same sorts of limitations should not be imposed on the independents because I think we are different, and we need the maximum flexibility to be able to compete.

We don't need and we don't deserve the kind of limitations that have been imposed on the Bell operating companies.

Mr. TAUKE. What kinds of limitations are you thinking about?

Mr. LUMPKIN. Simply their limitation to operating only in local exchanges.

Mr. TAUKE. Yes, Mr. Brophy?

Mr. BROPHY. Mr. Tauke, I think that we have to realize that there is, despite the separation imposed by the decree, a rather strong umbilical cord that will take a time to deteriorate that will exist between A.T. & T. and the Bell operating companies.

And the decree recognizes that in requiring Bell Laboratories and Western to prefer them in services up through, I believe, October 1987.

In addition, the Bell operating companies are permitted to have some kind of an undefined joint organization to provide those services that can be provided more effectively jointly.

So you do have the opportunity to reconstruct essentially a mirror image of the existing Bell operating companies with a different over structure. I think, as the other witnesses have suggested, until you really know what the final nature of that structure is going to be, it is very difficult to determine what are the appropriate restrictions to be imposed.

Mr. TAUKE. Do you think we should permit that kind of structure? And if so, what should be the nature of it?

Mr. BROPHY. Well, I don't think they or the witnesses here should try to renegotiate the Bell consent decree.

Mr. TAUKE. No, but that is essentially what we will be doing when we put together legislation.

Mr. **Brophy**. There have to be trade-offs between a free A.T. & T. and a very strongly chained Bell operating company group. And I would suppose that as you begin to free the Bell operating companies, then you have to impose greater restraints on the remaining A.T. & T. That was apparently the type of trade-off that was made in the negotiation of the decree.

Mr. **Tauke**. We have had a great deal of difficulty getting Bell operating company people to speak out on this issue from the perspective of the operating companies.

Obviously, they are still employees of A.T. & T., so they have a somewhat difficult situation in which they find themselves. You, on the other hand, have been running telephone businesses for some time. How would you feel if you were about to take over as manager of a Bell operating company, let's say, in my area, Northwestern Bell, with the restrictions that are being imposed by the A.T. & T. consent decree?

Would you believe that you were taking over a viable operation that had a future?

Mr. **Brophy**. I would be greatly concerned. I don't think I will be offered that opportunity.

Mr. **Tauke**. I don't imagine you will. But you are the best that we have got at the moment.

Mr. **Brophy**. I would be greatly concerned about my ability to serve the public effectively, to earn adequate revenue to support a building of the system. I would be concerned about the building around of my facilities by my former parent. And I really would be questioning today whether or not I wasn't being left a rather empty company.

It seems to me, in passing, strange that in dividing this very powerful horse, instead of cutting it down the middle, we have taken one end, the terminal equipment, and given it to A.T. & T., the other end, the intercity service, given it to A.T. & T. And what seems to me a rather hollow stomach at this point is now left with the Bell operating companies.

Mr. **Tauke**. Any of the rest of you have any comments?

Mr. **Reuss**. There is one thing I think we should mention.

A concern of the independents over the years has been the fact that the market power on the purchasing side of the integrated Bell companies has been quite different than that of the independents, in terms of access to electronic switching equipment and so forth.

I think that you have to raise the question: If there is going to be some consortium in amassing the purchasing power of the separated BOC's, whether the benefit of that should be confined to the BOC's, or whether all independents should have that benefit.

On the other hand, a counterquestion is whether that is best in terms of creating competition in the equipment manufacturing market. I think that problems that have been of concern in the past with respect to supply and procurement have to be thought about in terms of any consortium of Bell companies and its purchasing equipment in the marketplace.

Mr. **Tauke**. Let me see if I am getting the right picture. It seems to me the picture I am getting is that on the one hand the group of you are suggesting that maybe the Bell operating companies are being unnecessarily limited in some areas, and therefore their viability may be questionable.

But, on the other hand, you are somewhat concerned that we are going to have maybe one or two or three large Bell operating companies, perhaps with an overstructure. And those companies will have great competitive advantage over you or others in the telecommunications industry.

Is that a fair representation of what I am hearing?

Mr. REUSS. There are really two problems we are talking about. One is you might say their ability to work together in servicing the local market. That is one thing. The other thing is whether they will be confined forever to the local distribution market.

Mr. TAUKE. Right.

Mr. REUSS. That is another question.

Mr. TAUKE. Yes.

Mr. WOHLSTETTER. I think all of this thing has to be viewed with some kind of tongue in cheek, because historically throughout the Bell System, you have had people passing from C. & P. to Southwestern Bell to Illinois Bell and Northwestern and all over.

And there is a kind of family relationship, an incestuous relationship, almost, that I think it would be idle to suggest this would disappear at the stroke of a pen. There are lifetime friendships, commitments, understandings that are going to take some years to disappear.

Now, I don't know how you deal with that legislatively. That is why I am sure your people elected you. But from my standpoint, I don't believe, or let me say, if I believe that, I would also believe that the Russians were in Afghanistan to teach the natives flower arrangements.

Mr. TAUKE. Well, let's move over into some things that are a little more specific. I don't believe that I heard any of you talking about the definition of exchange areas by the Bell System. How does this impact upon you as independents, if the Bell System, apparently the Bell operating companies will be able to define the local exchange areas.

Does this have impact on you and your service?

Mr. HENSON. Again, it is very difficult at this time to visualize, and we are not privy to those discussions on the definition of an exchange area at this time.

Mr. TAUKE. Do you have concern about it?

Mr. HENSON. We obviously have concern about it, Congressman, yes, and have had some informal discussions with counterparts in the Bell System. The definition of an exchange area is going to be fundamental in determining just how many resources the Bell operating companies have left.

Some of the interoffice trunking, some of the extended area service trunking, and some interexchange facilities would be retained by the BOC's if the exchange area is defined broadly enough.

The definition will impact us on our interconnection with the Bell operating companies where we are serving in the same metropolitan areas, or in the same general areas. The ramifications for the economic viability of the Bell operating companies, going back to your former line of questioning, is paramount. The BOC's should have a broad enough area of responsibility and scope that their economic viability is not endangered prematurely.

Mr. **Tauke**. If you were, phrasing the question a little differently, if you were a Member of Congress and had all the wisdom Mr. Wohlstetter seems to believe comes with that office, what would you suggest that we do in this area? Should we attempt to legislate? Should we have the State public utility commissions be involved in the definition of exchange areas?

How would you suggest that we address this issue?

Mr. **Henson**. Well, I will volunteer an answer. I think, yes, the State regulators should be involved in this definition. I think that Congress should be involved in defining it as broadly as possible. I say that on the basis of my concern for the long-term economic viability of the separated Bell operating companies.

As Mr. Reuss and Mr. Brophy and others have indicated, the BOC's have a very narrow mandate. This mandate can be enlarged in the short term, and until some sunset or some revisitation is made of the situation, by a broadly defined exchange area.

Mr. **Tauke**. Mr. Brophy?

Mr. **Brophy**. Congressman Tauke, I think that it is easy to confuse the definition of exchange area in the consent decree with the definition or the jurisdictional definition that has been included in the legislation. Clearly, the consent decree cannot itself determine jurisdictional boundaries.

Those will remain the same absent legislation. But I do think the fact that there is some implication with respect to jurisdiction, that we perhaps see a clearer conflict between the FCC jurisdiction and the presumptions that were included in the consent decree.

Those do need to be clarified by legislation.

Mr. **Tauke**. I am not sure that I understand exactly what you told me. Do you want to try again?

Mr. **Brophy**. Let me try again.

Mr. **Tauke**. Recognizing that we are not all experts in this business.

Mr. **Brophy**. There has been a legislative proposal that the State jurisdiction be limited to the exchange area, and that the FCC have jurisdiction of all interexchange service and facilities. The consent decree seems to assume that jurisdictional definition implicitly. But obviously, the consent decree itself cannot deprive the States of the interexchange jurisdiction that they currently have within their States, so that you end up with an essential conflict between the exchange definition that appears within the proposed consent decree, and the jurisdictional definitions that will continue to exist under the Communications Act.

Mr. **Tauke**. Am I correct or incorrect in understanding that under the consent decree, an exchange area could perhaps be defined as an entire area code?

Mr. **Brophy**. I believe that is correct. I believe it is limited to an area received by a class IV office. And no larger than a SMSA.

Mr. **Tauke**. And that is part of the consent decree?

Mr. **Brophy**. That is part of the consent decree.

Mr. **Tauke**. Moving on to, I think it was Mr. Wohlstetter, that you mentioned that you had some concerns about the provisions in the legislation that seemed to suggest there would be some kind of government-administered fund that perhaps would include some surcharges. Do you believe we should look toward some kind of privately administered fund that would be designed to hold down local rates?

I understand that the separations are currently administered now by the private companies. Do you think we should continue to look at something like this, rather than something administered by a government-established body?

Mr. WOHLSTETTER. I would think that would be an ideal solution, since I think that we have been able to negotiate successfully among ourselves in the past. I think that is the best of all worlds, if we can't continue to look upon private industry as really an important segment in the United States, and not necessarily susceptible only to direction from the Federal Government.

On the other hand, it may be that a local pool which would in part be administered by the States might be as desirable.

Mr. TAUKE. Well, with the changing structure that we are going to have, how would this privately administered pool work? How would you structure it or how would you put it together to make it work?

Mr. WOHLSTETTER. I would not put it together much differently than it is today in the sense that those people who use the facilities are the local carriers, the local loops, and whatever funds they would normally, under the suggestion you made, be contributed to Federal regulation, be done locally at the State level.

That would be a way of handling it by States. And then the companies within those States could, by themselves, negotiate under the aegis of the State regulators a satisfactory arrangement.

Actually, from our standpoint as independents, and there are some 1,500 of us still left in this world, we have from time to time, by demonstrating to the Bell Co., which was then sitting in judgment, and I will point out that at one time we paid for the privilege of getting into the national switched network, we demonstrated what our costs were in such a fashion that our share of that pool has become a very important component in our earnings, and we have been able to negotiate this by demonstrating our capability of keeping books as well as they do.

Mr. TAUKE. Do the rest of you agree with what has been said? Do you have anything to supplement?

Mr. LUMPKIN. I wouldn't disagree with Mr. Wohlstetter that it might be viable to have the States administer the so-called separations funds. But I think it would be far preferable, because we are dealing with a national network and national telephone service, basic service, that it would be far more preferable to continue to administer it on a national level.

Mr. TAUKE. So we have one for national-administered and one for State.

Mr. WOHLSTETTER. No; I don't know whether Dick Lumpkin said that. Dick, did you say that you would like in this particular case that the Federal Government step into the shoes of American Telephone and do this for us?

Mr. LUMPKIN. I certainly did not, no, sir.

Mr. WOHLSTETTER. Oh, I see.

Mr. TAUKE. OK, who is going to step into the shoes of American Telephone and do this?

Mr. LUMPKIN. Well, I think that it is not that American Telephone has done this in the past solely by themselves. It has been a negotiated process between the telephone companies and under the supervision and direction of the Federal regulators and the State regulators.

And the so-called joint board process. I would envision it could continue very well, continue much the same way.

Mr. TAUKE. So the money would continue to go to A.T. & T. for distribution.

Mr. LUMPKIN. It wouldn't necessarily have to.

Mr. BROPHY. The money doesn't really go to A.T. & T. for distribution today.

Mr. TAUKE. How does it work?

Mr. BROPHY. There is a formula. If a company accumulates funds that are within its allowance in the formula, it keeps those funds. If it owes funds to A.T. & T. it forwards those funds to A.T. & T.

If it owes them to another company, it forwards it to them. If A.T. & T. owes to the local company, it forwards it to the local company.

So there is no one large bank account in which these funds are first accumulated and divided. And it is the establishment of the formula under the aegis of the FCC and the State commissions that is the important element. Then it is merely a matter of accounting between companies, which is subject to audit, and on which the companies really don't have any basic disagreements.

Mr. TAUKE. And you think that can continue to work? Yes?

Mr. REUSS. I would like to point out, if you adopt the presumption of a complete cleavage between local distribution facilities and the intercity carriers, you have introduced a complexity that was not there before; that, the revenues from the toll access charges are part of the local revenue requirement, whereas the toll switch and interconnecting trunks are truly intercity.

So that you have really three players in this. The local telephone companies, A.T. & T. as the dominant carrier, and the OCC's.

So I suggest that if you were going to do some pooling of access charges, it would probably involve pooling of the revenue requirements of local telephone companies.

But intercity carriers are on the other side of the equation, if you really believe in this island concept, I am wondering if there isn't some different process that is required, some mechanism whereby the local telephone companies who are pooling their access charges must be involved, rather than A.T. & T. or an intercity carrier operation.

I think it is a complex issue.

Mr. TAUKE. Yes, Mr. Henson?

Mr. HENSON. I am not sure that I am going to shed any light on this, but I will try. The entire A.T. & T. corporation, together with USITA and other organizations, handle the transfer of funds by administering the process. The process administration could move over to the Bell operating companies, once separated. The consent decree does anticipate a service organization or some kind of a staff group.

That group, together with existing organizations, could conduct the administrative process in the settling of accounts. As Mr. Brophy described, we don't send checks back and forth. It is an accounting process. I believe it is workable, Congressman.

Mr. TAUKE. There are many more questions that I have on my list here, but I have been a half hour already. So I do want to thank you. This has been very educational, and I hope you will continue to keep in touch with us as we attempt to work through this legislation.

Mr. WIRTH. Thank you, Mr. Tauke.

Four areas I wanted to review.

First of all, starting with the access charge and its potential to become too high, thereby creating incentives to bypass the local network. As I understood your testimony, you commented on that. I was wondering if you might summarize your position on that, and then we might ask the other members of the panel to react.

Mr. BROPHY. Yes; the whole subject of access charges and the acronyms SPF to SLU probably befog the issue. Let me try to clarify it to some extent. The specific factor is a charge for nontraffic-sensitive costs of the local network which are allocated to the interexchange network and used to support local service. At a time when there were no competitive intercity networks, and at a time when there was no problem or conceivable possibility for the interexchange carriers bypassing the local network, the level of that charge, the specific charge, area access charge, was not important.

It could rise to any level without impairing the level of service or impacting on competition. But as soon as you introduce competitive service, you have two possibilities. You have the possibility of competitors as we have today, the MCI's and Southern Pacific's, paying a different access charge than the integrated network.

The integrated network pays a higher access charge today, the SPF factor. That puts the integrated network at a competitive disadvantage with the OCC's. If in the future you have equal access charge, then the level of that access charge becomes critical in determining whether the intercity carrier finds it more economical to bypass the local network, or more economical to use the local network.

If the charge is kept at a high level, there will be a much greater incentive to bypass the local network. And if the local network is bypassed, the differential between SPF and SLU is not only lost, but the whole access charge is lost.

The result could be a much higher exchange rate occasioned by encouraging more bypassing of the local network than would be necessary if you keep the access charge at a level that encourages the use of the local network.

Mr. WIRTH. Would any of the others like to comment on that, or agree with that?

Mr. WOHLSTETTER. I think that is an absolutely critical factor, and I agree with Mr. Brophy, that the temptation, the political temptation which currently exists locally in any event to just sit on local rates and hope that the return on long distance or MTS services will permit them to give people a service below cost, which I assure you in our very rural telephone situation occurs much more often than not, is one that is almost irresistible.

Now, if you place the entire responsibility for the setting of local access charges in the hands of the local authorities, without any kind of methodology set forth by the Federal Government, you have a situation which could have easily been destructive because it is a curious fact that perhaps 60 percent of all of the long-distance telephone charges in the United States are generated by about 4 percent of the customers.

And if your OCC's, or the Long Lines Co., are tempted to go to your principal independent user in a local area, he can raise your revenue requirements for the local side to such astronomical figures that people will not either take service, or will be charged very unreasonably for it.

Mr. WIRTH. Mr. Henson, Mr. Reuss, or Mr. Lumpkin, do you agree with what Mr. Brophy and Mr. Wohlstetter were saying?

Mr. HENSON. Yes, I do, Mr. Chairman. This is a critical issue. We do have to de-load the intercity services, as Mr. Brophy described, in order to keep access charges at a reasonable level. Otherwise, the bypass issue will become real.

Mr. WIRTH. Mr. Reuss.

Mr. REUSS. Mr. Chairman, I would agree. I think the time is near. We all think in terms of this bypass. Particularly in large cities with up-links and down-links to satellites with heavy users in concentrated areas, it is here. And we would be foolish——

Mr. WIRTH. So you would agree?

Mr. REUSS. I would agree. The only point I would like to make, my last point, we were going to have a very difficult time keeping up with technology. There may come a time when the best thing to do is not try to regulate the local distribution rates and instead let them fly with the marketplace. That may be sooner than we all think.

Mr. WIRTH. How does that relate to the question of the size of the access charges?

Mr. REUSS. In other words, what I am saying is that the access charge will be determined by market factors. You will charge individual customers for access based on what the cost of alternate ways of reaching the intercity facilities.

Mr. WIRTH. That assumes that you have a competitive intercity environment.

Mr. REUSS. Right. For example, cable television, broadband network, satellite, rooftop antennas.

Mr. WIRTH. Do we have the kind of competitive environment that would justify that today?

Mr. REUSS. I think we are rapidly approaching it in larger cities, where already there are microwave point-to-point networks being developed that will bypass the local distribution systems. I think we have it right now. It is not significant enough——

Mr. WIRTH. Going back to what Mr. Wohlstetter said, who are the people using those technologies?

Mr. REUSS. The heavy users. It is like in everything else. The heavy user has the opportunity to become a self-provider. Our public transportation systems are a perfect example of what has happened where a self-provider drives himself to work rather than using the public transportation system.

Mr. **Wirth.** It seems to me that you are then arguing, as Mr. Wohlstetter was, that if the access charge goes too high, those large users will have the incentive to become that self-employer.

Mr. **Reuss.** Absolutely. I agree with that.

Mr. **Wirth.** Then there is potential peril in that they go off the system. And then you have the local operating companies left with not those high volume 4-percent customers, but the other 96 percent of the customers who generate only 40 percent of the charges. When you get into the volume issue it doesn't look so good, right?

Mr. **Reuss.** I think that is a good analysis, right.

Mr. **Wohlstetter.** Mr. Reuss, you asked what kind of people do that. Let me say that in one of our divisions, American Satellite, now, we have been watching this thing develop over a period of years. And without saying whether we have agreed with some of the fiats set forth without public interest studies by the FCC, we decided a long time ago that nobody was interested in the facts. That nobody really believed telephone rates were going to go up.

If you read the newspaper the last couple of weeks, you could be equally as puzzled because on the day after, or the day of the consent decree announcement, Bill Ellinghaus said local rates would double.

Yet, Charlie Brown sat here and said, "Oh, maybe 8 percent." Well, they are both right and they are both wrong, because in some cases it will be a great deal more. Now, who uses this? Right today, Continental Telephone, through American Satellite, has 250 major corporations in the United States using point-to-point satellite communications within their own orbit.

In other words, Metropolitan Life has seven of their data centers tied together through our satellite system. All right now, the minute you begin giving foreign exchange service to those seven same systems, you have got a problem.

Mr. **Wirth.** Mr. Lumpkin.

Mr. **Lumpkin.** The comment I was going to make, I think we have identified the two elements that make the cheese particularly binding here.

The very short horizon on which technology is going to make bypass very feasible. And the other aspect of creating an economic incentive because of high access charges to actually bypass. I think that brings into the picture the necessity for nationwide pooling, or for some broad-based pooling in order to minimize the exposure as much as possible to creating an economic incentive for bypassing.

A good example would be, for instance, I think one of the best examples, if you take a look at Lincoln Telephone, and consider what would happen with Lincoln Telephone Co. if access charges were averaged only on a company basis. Here is a company that has one large metropolitan area and a lot of very small, high-cost rural territory which, if averaged in, would cause the access charges for Lincoln Telephone to go quite high. And it would put them obviously in a very vulnerable position with respect to bypass from other interexchange carriers.

Mr. **Wirth.** Let me see if I understand your response, Mr. Lumpkin.

The initial proposition was that if access charges go too high, you provide incentives for the high volume 4 percent to go off the network. You are suggesting pooling would partly solve that problem?

Mr. LUMPKIN. Well, it is a difficult situation because in a sense pooling does cause those costs to be driven up. But it seems to me that pooling on a broad——

Mr. WIRTH. How does pooling cause those costs to be driven up?

Mr. LUMPKIN. Because I think pooling would generally cause the costs in the lower cost access areas if averaged with the high cost access areas, drive those up.

Mr. WIRTH. How does pooling solve the problem? If those 4-percent customers go off the network, they are not paying into the pool, so therefore pooling does not do you any good, right?

Mr. LUMPKIN. That is right.

Mr. WIRTH. So let's leave pooling aside. Mr. Lumpkin, do you agree with what has been said previously, that if access charges are too high, you develop the incentive to drive people off the network? Do you agree with that?

Mr. LUMPKIN. Yes, I do.

Mr. WIRTH. You do. Well then, everybody agrees with that, is that correct?

Mr. HENSON. Yes.

Mr. WIRTH. Well then, we get back to what is a very real political problem in two ways. One, you have got the political problem of who manages and defines that access charge. If you do it, as one of you were suggesting, too much at the local level, every political incentive is there to appease the local customer by making the access charge very high, therefore keeping their phone bill down. That is one political problem.

Then you have a political problem here in Washington. There are a lot of Members of Congress who represent very rural areas, and it is going to be a strong argument for them to be coming in and saying let's keep that access charge very high. Do not go from SPF to SLU. Keep that access charge very high. Therefore, keep local phone rates down. Correct? So we have a local political problem and a congressional political problem related to this.

Is that a fair description?

Mr. BROPHY. I think that is right.

Mr. HENSON. Exactly.

Mr. WOHLSTETTER. That is exactly right.

Mr. WIRTH. Therefore it seems to me that it is very important that all of you, as people who are serving a lot of high-cost areas, rural areas as independents, make the point very clearly to people that there is no simple answer to this. You do not solve the problem by keeping everything at SPF, keeping all of those subsidies floating around. While that may have a short-term political appeal, it could be very destructive in the long run. Is that correct?

Mr. WOHLSTETTER. Yes, sir.

Mr. WIRTH. Is that a fair summary of the substance and politics of the situation?

Mr. WOHLSTETTER. That is a very fair summary. The only thing I would add is that I do not think in the casual conferences which some of us have had with one another at conventions or other interesting places we have, any of us, had the——

Mr. **Wirth**. Testifying in front of the Congress. Trying to get in from Dulles Airport.

Mr. **Wohlstetter**. I just happened to pass him in the airport. That was all. Any of us have had the idea that SPF should not be topped, because the very thing which we would like to avoid would be created if you had a runaway SPF factor.

So that there is in other words some sense of balance and proportion that has to be used on the part of the industry itself, just as a political choice must be made by the Congress. You really have your constituency, which would like to get unlimited local telephone service for $11 a month. Well, that is not going to be possible under these conditions where the cross-subsidization, which undoubtedly exists, existed, and existed for the specific purpose of providing the kind of telephone service that is now available nowhere else in the world.

Now you are changing the ground rules. But when you change them, remember that a certain number of these people will either have to be subjected to local message metering, where there is enormous local resistance, people get on the telephone and they talk for 2 or 3 hours, somebody else might only use the telephone three times a week. And it is a problem, really, where the political niceties are in your hands, and the commonsense business practice is the only thing that we can lay before you.

Mr. **Wirth**. Mr. Brophy.

Mr. **Brophy**. Mr. Chairman, could I make just one point that I think is very important that Congress had in mind? That you cannot really open up competition and let the marketplace act, and at the same time, expect to have the same pricing system that was born and existed under a closed entry monopoly system. I think the airline industry is a very good example of that. Let me just cite you some figures.

Some of these appeared in a New York Times article last Sunday. We have the 30 largest airline carriers today losing $300 million this year, and we have 80 domestic carriers as against 32 in 1978. Between New York and Miami I can fly for $77, but if I want to fly from New York to Atlanta, Ga., which is a 30-percent shorter route, it costs me $187. At the same time, the airline industry's measure of what a passenger pays, or what they call yield, has actually outstripped the CPI in the last 4 years.

At the same time, we have seen service to a number of smaller cities badly cut back. And I think that that is the kind of thing that you have to expect to happen if you are going to open up this industry to the full effective kind of competition that has been proposed by many people. That you cannot expect to have the same pricing system and pricing levels in all elements of the system, and still consider that you have opened up a competitive environment. You cannot have the two together.

Mr. **Wirth**. Do you all agree with that?

Mr. **Wohlstetter**. Very definitely.

Mr. **Wirth**. I understand what you are saying in terms of the transition from a monopoly to a competitive environment. But I think we do want to look carefully at the airline model, and make sure that we do not get into a situation where a number of rural communities or smaller city communities are cut off from access which has happened in the airline world.

Or that we get into the bizarre rate structure that now exists as in the New York-Miami versus New York-Atlanta example. That certainly is not the kind of pattern that we would want to establish if we assume that everybody in the country should have access to the telecommunications system in an equitable fashion, right?

Mr. **Brophy**. I think that is the critical issue.

Mr. **Wirth**. Let me come back, Mr. Lumpkin, for my next question. What is USITA's position on access charges?

Mr. **Lumpkin**. Simply that they should be pooled on as broad a basis as possible.

Mr. **Wirth**. Before you can even think about pooling, you have to have revenues to pool. Let's go back to the question, what is USITA's position on the size of that access charge and on the Brophy thesis of 20 minutes ago?

Mr. **Lumpkin**. I think USITA feels that we have gone so far as to file a position with the FCC, that we do believe in capping SPF. That we do believe at some point the level of access charges is going to have to be reduced in response to marketplace conditions.

We feel that the burden on toll is going to have to be reduced over time. USITA's position is, however, that the level of access charges and the contribution that now flows to supporting high cost areas should be kept as high as feasible.

Mr. **Wirth**. Could we get from you that submission you made to the FCC on capping SPF? It would also be very helpful to get USITA's response to the thesis set out here, that if you set too high an access charge, you provide the incentive to go off the network.

Mr. **Lumpkin**. We would be happy to provide that.

Mr. **Wirth**. Anything else you all would like to comment on in terms of the access charge? Shall we move on? Let me get into some other issues related to the long-distance area.

One of those spins off from the Brophy thesis. It goes something like this. If you provide access charges that are too high, people are going to move off the network. Who is going to then have the greatest incentives to provide off network services? What carrier would have the greatest incentive to do that?

Mr. **Brophy**. I suppose a deregulated A.T. & T. is going to have an equal incentive with any other OCC to provide off network services. And there is going to be a strong incentive on the part of the largest users to look at private networks as an alternative to the use of the public network, also.

Mr. **Wirth**. Would A.T. & T. have the greatest incentive to bypass the network if they were allowed to provide duplicate facilities and services on an unregulated basis?

Mr. **Brophy**. I think clearly they have the greatest opportunity. There is no separation requirement in the consent decree. And because they are presently in a position of having facilities nearer more of the larger users than anybody else, why, they are the obvious—in an obvious position to grab the largest market share.

Mr. **Wohlstetter**. I would say Ted is absolutely right. It is the opportunity, rather than incentive that I think we should be addressing, because if MCI has 125 cities that they reach by virtue of their terrestrial network, and Baby Bell, or Long Lines, has 2,500, and they experience the same access charges and relatively the same costs, then if anybody is going to take advantage of the service, certainly with the quality difference that exists as well, the opportunity is going to be for Long Lines. They will be in more places. They will be able to invade more local loops. And they will be there.

But they will not be alone, because these other people are out busy borrowing money in Europe and getting ready to build parallel networks, if you like.

Mr. WIRTH. Mr. Reuss.

Mr. REUSS. I think the greatest opportunity might well be the supplier with the newest and cheapest technology who is trying to serve the customer with the greatest density of use point to point. There is where the greatest opportunity for bypassing exists.

A.T. & T. does have large embedded investments. A new entrant may well have no embedded investment and be completely able to capitalize on new technology.

Mr. WIRTH. What if A.T. & T. were to offer the newest technology in competition with its own Long Lines?

Mr. REUSS. I think there is an opportunity for A.T. & T. as long as they, can compete, on an incremental cost basis, with the newest technology.

Mr. WIRTH. Then you get into the Wohlstetter 4-percent problem again, right? You are providing then even greater incentives to pull that 4 percent off the system.

Mr. WOHLSTETTER. A.T. & T. is doing that right now. As a matter of fact, we in the satellites, which I assume is one of the disciplines Bob was referring to, have been competing with American Telephone. They are out busy trying to invade that. What they would like to get is that whole 4 percent if they could into a private network that operated through the facilities of the Bell Co. You know, if that is the way the business——

Mr. WIRTH. On an unreglated basis, is that right?

Mr. WOHLSTETTER. Sure. If that is the way the business is to be conducted, I do not blame them. What else?

Mr. WIRTH. Let me see if I understand what you were saying, Mr. Brophy. As I understood your testimony, you were saying that until the overall long distance market becomes truly competitive, that Bell should not be authorized to offer duplicate long distance facilities and services on an unregulated basis, is that right?

Mr. BROPHY. I think I would have two positions. That they should not be permitted to serve the end customer except through the local provider of service. And that they should not be permitted to provide on a regulated basis the same services that they are providing on a regulated basis. Otherwise, the incentive——

Mr. WIRTH. In other words, they should not be allowed in long distance——

Mr. BROPHY. To provide basic telephone service on an unregulated basis.

Mr. WIRTH. Or to provide long-distance service on an unregulated basis.

Mr. BROPHY. Yes.

Mr. WIRTH. Do you all agree with that?

Mr. WOHLSTETTER. I agree with that.

Mr. **Reuss**. I have a little problem with that. I want to make sure there is no shadow effect on that with respect to the independents. I think there could well be a circumstance, and I would think in Continental's case, where a very large customer is bypassing a toll switch in Continental, and there is an opportunity to connect them with American Satellite. I would hate to see Continental forestalled from doing that.

Mr. **Wohlstetter**. Oh, you would not see that, Bob.

Mr. **Wirth**. Let's leave that problem aside for a minute and focus on the dominant carrier here for a second, Brophy Thesis II, right? That is, in long distance, Bell should not be allowed, until there is a competitive market in long distance, to be able to offer service in competition with their regular Long Lines service. Is that a fair summary?

Mr. **Brophy**. Yes.

Mr. **Wirth**. Do you all agree with that?

Mr. **Reuss**. I would say maybe. I do not know.

Mr. **Wirth**. Mr. Henson.

Mr. **Henson**. I would like to tack just one caveat on that, Mr. Chairman. The long distance markets or the intercity marketplace is going to become competitive—if it is not now—in certain cross-sections on a route-by-route basis. Hence, when you say until the intercity marketplace becomes competitive, we must consider those routes out in the Shortgrass country again, where there may never be intercity competition. But in the Washington-New York-Boston corridor, there is fierce competition today.

We need to be a little careful about how we define competition, and not apply the definition broadly in the entire intercity marketplace.

Mr. **Wirth**. Is it possible to define the long distance market in terms of a New York to Boston or New York to Washington or New York to Chicago market as different from the New York to Shortgrass, Iowa, market?

Mr. **Henson**. Yes, anything is possible in theory. And I think it is possible in practice Mr. Chairman.

Mr. **Wirth**. Mr. Brophy.

Mr. **Brophy**. I would suggest that changes in technology make definitions more and more difficult, because if you are using a satellite where distance does not impact cost, it is merely a matter of putting an Earth satellite in. There may be no difference between the competitive impact on various locations in the country. But I would surely not suggest that when effective competition has been developed, that A.T. & T. then should not be permitted to compete through a separated affiliate.

I would think they should. I think the problem is one of market share, and the various studies that have been done by the PIM's group in Cambridge indicate that market share is critical in determining ability to compete and the cost structure of the competitors. Ninety-six percent of the marketplace so far overshadows any other competitor in terms of cost opportunity, that there would have to be a substantial change in that market percentage before effective competition could take place.

Mr. **Wirth**. We had a great deal of trouble, Mr. Henson, in looking at long distance markets. It is a very vexing question, a very complicated one. We came to the conclusion, spending a great deal of time on it, that you could not look at long distance as a market that was separable—for example New York to Washington—versus the broad national geographical reach and volume, which is really what long distance is all about.

A carrier must have the ability to provide long distance service to big users, small users, high-volume users, low-volume users, and people who want to have geographical reach. And you cannot separate out Chicago-St. Louis or Los Angeles-San Francisco from those other requirements of volume and reach.

Therefore, we concluded that you could not say one part of the market is here, and that the rest of the market is someplace else. Theoretically, you cannot develop that kind of ground work. Therefore, you have to look at the overall market and then treat it as to what is and is not competitive.

Mr. **Henson**. I do not disagree with that at all, Mr. Chairman. Perhaps I could clarify by saying that I think in the degree of economic regulation and pricing flexibility is where we might be able to recognize the degree of competition in a given route. In defense of an old theory of ours, we really need nationwide average rates. It has been to the benefit of the American public that we continue average rates.

Yet, there is route competition, and where there is substantial competition and a well-defined division of market share, that discount pricing ought to be allowed in that sector, as opposed to nationwide average pricing in noncompetitive cross-sections.

Mr. **Wirth**. And that then the national issue gets taken care of in that fashion through the access charge.

Mr. **Henson**. Yes.

Mr. **Wirth**. Which is where I think everybody pretty much agrees.

Mr. **Henson**. Apparently so.

Mr. **Wirth**. Two other issues, one quick one and one more complicated. One is the issue of jurisdiction over the access charge: Defining it, whether it is done at the FCC, done in legislation, done at the FCC, or done at the State level. We had some discussion about that this morning, a lot of discussion over the last month as to who has that jurisdiction and how we should set that up.

On the one hand, the argument is made that it has to be done with national guidance because you are looking at a national system overall, and we want to maintain a national communications system. The other end of the argument is that since it is the local communities and local PUC's that best understand what costs are, that they ought to set the charge.

Could I get your reactions?

Mr. **Wohlstetter**. Well, what I said was that in our view it should be local, set locally under a methodology prescribed by the Federal body.

Mr. **Wirth**. Does everybody agree with that?

Mr. **Henson**. I do, sir.

Mr. **Brophy**. Yes.

Mr. **Wirth**. Everybody does agree. Mr. Lumpkin, do you?

Mr. **Lumpkin**. I think USITA's official position is that it should be set with local participation under Federal regulation and Federal directive.

Mr. **Wirth**. Finally, let me ask you about the cross-subsidy issue which was raised early on by one of you, the relationship in between regulated Long Lines and unregulated entities, in that parent company.

First, is there a problem there? And second, if there is a problem that exists there, should there be some kind of safeguards against cross-subsidy flowing in either direction? Both directions were referred to this morning.

Mr. Brophy.

Mr. **Brophy**. It seems to me Assistant Attorney General Baxter focussed only on what he perceived to be an evil bottleneck that existed because of the ownership of the local operating companies. I am not sure that is not really a strawman, and he neglected the tremendous strength that the monopoly of the interexchange-intercity facility gives to A.T. & T.

And with that monopoly and the percentage of revenue that is generated by that monopoly, clearly there is an opportunity for cross-subsidy of nonregulated businesses if they can be provided by the same entity without any requirement for separation.

Mr. Baxter's thesis assumes that there is already, or will very shortly be sufficient competition in the intercity-interexchange service so that in fact A.T. & T. can be completely deregulated, and therefore there is no need to differentiate between regulated and nonregulated service.

But given the level of that monopoly, I think it is very unlikely that we will see that happen for a very long period of time. And I think that is a great weakness in the decree itself.

Mr. **Wirth**. Therefore what should be done, Mr. Brophy?

Mr. **Brophy**. Therefore I think you do need restrictions and separations between regulated and nonregulated businesses within the remaining A.T. & T. entity.

Mr. **Wirth**. Do all of you agree with, one, the analysis, and, second, the conclusion?

Mr. **Reuss**. I would like to comment on it. I agree with Mr. Brophy that there should be separation. I think the real question is relating to what is monopoly network service, and what is enhanced service. And while we have talked about the advantages of the monopoly network, if you impose on A.T. & T. an anywhere to anywhere responsibility, a supplier of last resort responsibility, it must be an umbrella to see that that is cared for.

There are some disadvantages as well as advantages. I think the question still has to be related as to where some enhanced services fit. Whether they fit in the so-called nonregulated subsidiary or remain part of the monopoly network.

So I do not think it is a completely clean issue but I agree with the conclusion of separation.

Mr. **Wohlstetter**. I think I said in my statement that initially A.T. & T. should be structured so it cannot use revenues from intercity distribution services to subsidize its other businesses. Other than that I believe what Mr. Brophy said is correct.

Mr. LUMPKIN. I would just comment that USITA does believe in the separation of regulated and competitive services. And that certainly when the area of competitive services that all of us be given, or the independent companies, be given the maximum freedom to compete. The question of how there should be structural separation or structural requirements imposed upon the Bell System is something that USITA has not addressed and I can't comment on.

Mr. WIRTH. Any other comments?

Mr. REUSS. I would like to add that I believe that there should be some Federal preemption of this issue so that one State does not decide the separation one way and another State the other with respect to those of us who operate more than one State.

I think that would be a horrible mish-mash for us to operate under.

Mr. WIRTH. Therefore, if we are talking about a national system, it is imperative that, if there is going to be some kind of a safeguard, it has got to be done through legislation. I would assume that is the case unless the settlement takes care of that issue. Does the settlement resolve this problem?

Mr. REUSS. I think what I was referring to, let's take the selling of terminal equipment, which would be an activity of an A.T. & T. subsidiary, presumably. It seems to me with respect to the independents, if there are to be some safeguards with respect to the selling of terminal equipment, that that not be left to the States. That we not have different structural regulations among the States with respect to that issue.

Mr. WIRTH. Keep in mind for the moment the Bell operating companies down here, Long Lines and Western Electric up here. We are talking about the relationship of Long Lines to Western Electric. That is what we have been after for the last 15 minutes.

Mr. BROPHY. No. Long Lines to Western Electric is a completely different subject. That is a question of the supply of equipment and the effectiveness or lack of effectiveness of the decree in opening up the equipment market. That is a very different subject from the question of whether or not A.T. & T. as at least initially a provider of regulated intercity service can also provide unregulated intercity service through the same entity.

Mr. WIRTH. Sorry, I didn't make myself clear. Let's move to the relationship between regulated Long Lines and Western Electric.

That is the final thing I wanted to get at. We were talking earlier about duplicate facilities and services, regulated, unregulated. Let's leave that aside for the moment and talk about the relationship between Long Lines and Western Electric.

Is there a problem that is created there of potential cross-subsidies between those two, which was mentioned by a couple of you? And if so, if that problem exists, is it taken care of in the consent decree?

Mr. BROPHY. I think the problem is not so much one of cross-subsidy, although that exists. I think the Assistant Attorney General Baxter threw up another strawman when he seemed to assume that the problem he was attacking was the sale by Western Electric of equipment to the Bell operating companies at prices in excess of their true market value. That has never been an issue. What he has done therefore, is separated the Bell operating companies from Western Electric and let Western Electric and A.T. & T. as a single entity, with no restriction or requirement for open purchasing.

At the same time he has left Bell Laboratories with them. Oddly enough he has left the ownership of Southern New England Telephone Co. and Cincinnati and Suburban as minority holders, although they have been part of the licensed agreements, undisturbed.

The problem it seems to me that is created is the termination of the 1956 consent decree and elimination of the patent licensing agreements and technical know-how agreements, really puts Western in a position in the future as being the sole and unchallenged provider of equipment to A.T. & T. with a 96-percent monopoly of intercity service.

A.T. & T. can then determine the technology of the transmission facilities, and those at the end of the line, the Bell operating companies and independent telephone companies could be in a position in order to interconnect that they would have to use Bell technology or in effect, buy their local switches from Western Electric.

The unavailability of the technical information and licensing to other manufacturers is surely going to decrease the competitive opportunity, rather than increase it.

Mr. **Wirth**. Would any of the others like to comment on that?

Mr. **Wohlstetter**. I, not being a manufacturer, I am pleased to say, I would not comment except to say that I see the logic in Mr. Brophy's remarks, and I agree with him.

Mr. **Henson**. I would simply say, Mr. Chairman, that I see the potential for not only cross-subsidy, but also the potential for purchasing difficulties. Why A.T. & T. has insisted on keeping Long Lines as a division, rather than a separate subsidiary all these years, I do not know.

It would seem to make sense from A.T. & T.'s standpoint, from everyone's standpoint, to have Long Lines as a clearly defined separate subsidiary. That would prevent a lot of allegations and litigation, while enhancing competition.

Mr. **Reuss**. I alluded earlier to my concern that a continued coordinated purchasing by the Bell operating units en masse, without individual local decisions, could conceivably continue the problems Mr. Brophy relates to. I would think over time if the Bell BOC's have independence with respect to their procurement judgments as we in the independent industry have, maybe that would solve some of this relationship with Western.

Mr. **Wirth**. Mr. Lumpkin.

Mr. **Lumpkin**. I have no comment.

Mr. **Wirth**. Fine. You all have been here for a long period of time. I greatly appreciate your time here which is rivaled only I think by Mr. Brophy's time on the highway at the time of the last snowstorm from Dulles. Do any of you have any closing comments or thoughts or suggestions that you would like to provide for the record at this point? If not, as you know, the record will remain open for your comments. I think that we have covered a lot of very helpful ground here, and I greatly appreciate your being here. Thank you very much.

Before hearing from the State of Alaska we will take a 5-minute recess.

[Brief recess.]

Mr. WIRTH. The subcommittee will come back to order.

Our final panel this morning focuses on the problems of the State of Alaska. We have Mr. Alex Hills, deputy commissioner for telecommunications services, department of administration, John McGill, vice president for regulatory affairs, Alascom, Inc., and Joseph Moreland, senior vice president of Anchorage Telephone Utility in Anchorage.

Gentlemen, thank you very much for being here. You have been preceded by a good deal of advocacy from your good Congressman Young and Mr. Wilson Condon, now the attorney general in the State of Alaska.

We are pleased to have you here. I think you are familiar with the rules of the subcommittee. We would hope you would be able to summarize your testimony in 5 minutes or less, then we will get into questions and comments. Your statements will be included in full in the record.

STATEMENTS OF ALEX V. HILLS, DEPUTY COMMISSIONER FOR TELECOMMUNICATIONS, ALASKA DEPARTMENT OF ADMINISTRATION; JOHN E. McGILL, VICE PRESIDENT FOR REGULATORY AFFAIRS, ALASCOM, INC.; AND A. JOSEPH MORELAND, SENIOR VICE PRESIDENT, ANCHORAGE TELEPHONE UTILITY

Mr. HILLS. Mr. Chairman, members of the subcommittee, thank you for providing me this opportunity to speak on a matter of critical importance to my State.

My name is Alex Hills, deputy commissioner for telecommunications in the Alaska department of administration. Previously I was chief of the communications carrier section of the Alaska Public Utilities Commission and prior to that, president of the Telephone Cooperative which serves a number of communities in northwest Alaska.

I have brought from Alaska a letter addressed to you, Mr. Chairman, from Governor Hammond. In his letter the Governor explains that he is unable to be present today and that he has asked me to testify in his place. The letter also expresses the belief that the development of universally available telephone service is critical to the State of Alaska. I have provided copies of the Governor's letter and ask that it be made part of the record.

Mr. WIRTH. Without objection that will be included in the record.

Mr. HILLS. Mr. Chairman, we in Alaska are uniquely concerned with telecommunications issues. Alaska is one-fifth of the size of the contiguous 48 States. While it covers 586,000 square miles, the State has only 400,000 residents, nearly half of these live in the largest city, Anchorage.

Ninety-five percent of our communities qualify as rural. In spite of its enormous size Alaska has only 2,200 miles of paved highways, fewer than the State of Connecticut. Most of our communities are accessible only by boat, snowmobile or aircraft. For these reasons telecommunications plays a unique role in our State. That is why the State has been active over the years before the FCC in telecommunications issues and why the State has followed and participated in the communications legislative process now underway. This committee has recognized that technological and economic developments have led to a highly diverse and competitive telecommunications marketplace.

You have also recognized these fundamental changes will require an appropriate legislative response to ensure that competition is enhanced and to insure that universal service is extended to those who do not have it, and preserved where it exists today.

Universal service does not today exist in Alaska. While modern efficient telephone service is available in Alaska's cities and in some remote communities, many Alaskans pay substantially higher rates than consumers in the lower 48 for comparable services. In contrast to the situation which exists in the lower 48, rural service in Alaska is only now being developed. Since Alaska's remote communities are too small and too widely dispersed to support a telecommunications system designed using lower 48 methods, it was the advent of domestic satellite service in the early 1970's that made modern efficient statewide communications possible.

During the last 6 years satellite stations have been built in many remote Alaskan communities. These stations brought with them for the first time reliable long-distance telephone service. However this service is not the kind which many in the lower 48 take for granted. In most of America residents have available private- or party-line telephone service. In many Alaskan villages all residents of a community share a single common telephone. All calls are long distance, and during busy periods there is often a substantial delay before a call can be made.

Long-distance calling is used in a unique way in many Alaskan communities. Most of our villages have extremely limited services available locally. Thus, long-distance telephone calls are typically used to order groceries, check on availability of needed repair parts, and to talk with a doctor or request emergency services. Long-distance calling is used by our villagers in the same way that local calling is used by most Americans. Conventional phone service is now being extended to many of our villages. Exchange telephone companies have received certification from the Alaska Public Utilities Commission to serve Alaskan villages, and exchanges are now being built in many of these. This development will bring to these communities service which is comparable to that enjoyed by residents in the remainder of the United States, but long-distance calling will continue to be used in the way I have described.

Alaska's accomplishments have been possible because of the economic support presently provided through cost-sharing and low interest financing arrangements, arrangements which are based on the principles that universal service is a benefit to all who use the telecommunications system, and that the costs of extending the system to certain remote locations should be shared by all users.

H.R. 5158 recognizes this. Section 101 provides that one of the purposes of the bill is to make available to all people of the United States efficient nationwide and worldwide telecommunications at reasonable and affordable charges. This language has a more serious and more direct meaning for Alaskans than for most Americans because for us, universal service is not yet a reality. This is why we have reviewed H.R. 5158 very carefully to determine whether the needs of Alaska and other rural areas are met. We are concerned that while the bill goes a long way toward achieving this universal service mandate, H.R. 5158 will not, as written, entirely achieve the stated objective. We feel that the provisions creating support to insure universal exchange telephone service at reasonable rates will be adequate with the addition of certainly minor changes which are outlined in the statement I have submitted with my testimony.

However, we are concerned that there is presently no provision in H.R. 5158 which would help support the cost of delivering long-distance services to these remote communities. Unfortunately, while the reliance upon long-distance services is much greater than it is in the lower 48, the cost of providing it to remote communities in Alaska is much higher. If the few residents of these communities are alone forced to shoulder the burden of these higher costs, service will be unaffordable, and, as a practical matter, denied to many Alaskans.

We believe that this committee must recognize as it did in drafting H.R. 5158, that support will be needed for certain long-distance services, and that amendments are necessary to accomplish this objective. I have outlined what we believe are appropriate changes in my accompanying statement.

Mr. Chairman, we in Alaska stand ready to assist you in understanding and appreciating the unique needs of Alaska's telecommunications users. And together, I believe we can achieve legislation which will make universal service a reality.

Thank you.

[Testimony resumes on p. 819.]

[Mr. Hills' prepared statement and letter referred to follow:]

JAY S. HAMMOND

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 11, 1982

The Honorable Timothy Wirth, Chairman
House Energy and Commerce
Telecommunications Subcommittee
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Wirth:

Prior commitments have prevented me from attending this hearing and personally presenting testimony on telecommunications issues. I have, therefore, asked Mr. Alex Hills, State of Alaska's Deputy Commissioner in charge of Telecommunications, to represent me in this hearing and present Alaska's testimony.

Telecommunications facilities and services available at reasonable and affordable rates are essential to the conduct of government, commerce, and private life in Alaska. Additionally, future development of the State's public and private sectors will depend greatly on the use of new telecommunications services and techniques now becoming available. Moreover, these facilities and services should be available, to the extent possible, to all citizens of the state, regardless of location. We, therefore, believe it best serves the public's interest for the state and federal government to facilitate the development of both basic and advanced telecommunications services and facilities to be available to all Alaskan citizens.

Although our telephone network has developed rapidly in recent years, particularly in the rural areas, Alaska has not reached the goal of universally available telephone service. In fact, half of our communities still do not have telephone exchange service. I urge you to take careful note of this fact in considering changes to the Communications Act of 1934. It is important that telecommunications legislation be written in a way that will allow the continued development of the Alaskan telephone network. I think you will agree that this is important to Alaska and to the Nation.

I appreciate the opportunity to present Alaska's concerns to the subcommittee and thank you for your consideration.

Sincerely,

Jay S. Hammond
Governor

STATEMENT OF ALEX V. HILLS

DEPUTY COMMISSIONER FOR TELECOMMUNICATIONS

STATE OF ALASKA

I. INTRODUCTION

Alaskans are uniquely dependent upon reliable, low-cost, telecommunications services. Alaska is one-fifth the size of the contiguous 48 states. While Alaska covers 586,000 square miles, the State has only 400,000 residents, and nearly half of these live in the State's largest city, Anchorage. Ninety-five percent of our remaining communities qualify as rural. In spite of its enormous size, Alaska has only 2,200 miles of paved highways, fewer than the State of Connecticut. Many of the State's rural communities are accessible only by aircraft, but, too often, aircraft operations are marginal, at best, during the winter months. Thus, telecommunications plays a unique role in Alaska. For these reasons, the State has been active before the FCC in telecommunications issues and it has followed, and participated in, the communications debate in Congress now underway.

II. OUTLINE OF ALASKA TELECOMMUNICATIONS DEVELOPMENT

Alaska's telecommunications system has evolved quite differently from the system which serves the lower-48. At the time it became a state in 1959, Alaska was classified as a foreign point for telecommunications purposes. From that time until 1971, long lines service was provided by the Alaska

Communications System (ACS), a military system operated by the U.S. Air Force. The ACS provided service to non-military users whenever circuits were available but the system was not designed, or expanded, to meet civilian needs. Local exchange service was provided in Alaska's larger communities by both municipal systems and private companies.

By the late 1960's, DOD had determined to obtain as much of its communications capacity as possible from commercial carriers and, as a consequence, decided to place the majority of the ACS system in private hands. As a result of a competitive bidding procedure, RCA Alaska Communications, Inc. (RCA Alascom) purchased the ACS from the government. RCA Alascom agreed to upgrade substantially the existing ACS system and to extend telephone service to 142 remote ("bush") communities. In 1979, RCA sold RCA Alascom to Pacific Power and Light. The company is now called Alascom, Inc

At the time of the ACS purchase, a large majority of Alaska communities had no telephone service. Since then, domestic satellite facilities have been used extensively to make rural telephone service possible. Exchanges have been installed in some communities by independent companies and by customer-owned cooperatives. There has been considerable progress over the past decade, and the development of our telephone network is continuing. Our progress thus far has been made possible by sharing of costs through the existing nationwide separations and settlements system as well as through low interest financing from the Rural Electrification Administration.

Long distance calling is used in a unique way in rural Alaska. Most of our rural communities have extremely limited goods and services available locally. Thus, long distance telephone calls are typically used to order groceries, check on the availability of needed repair parts, and to talk with the doctor or request emergency services. Long distance calling is used by rural Alaskans in the same way that local calling is used by most Americans.

At the present time, about half of our communities (117) have local exchange service. Each of the remaining communities has a single telephone which is shared by all its residents and from which every call is a long distance call. Universal service is not yet a reality in Alaska.

While telephone development could be expected to continue under existing institutional arrangements, H.R. 5158 could significantly alter this course. Although the bill recognizes, and strengthens, the basic commitment to universal service contained in the existing Communications Act, the provisions relating to access charges and the National Telecommunications Fund may be inadequate to accomplish this objective in Alaska.

III. WHAT H.R. 5158 DOES FOR ALASKA

H.R. 5158 contains a number of terms which will help secure universal service in Alaska. Section 101 provides that a purpose of the bill is:

> To make available to all people of the United States efficient nationwide and worldwide telecommunications at reasonable and affordable charges;

This universal service mandate appears in the existing Communications Act and, since universal service at reasonable rates is not today a reality of Alaska, this language should remain as the Commission's first guiding principle.

The universal service principle is again set forth, in essentially the same language, in sections 201(a) and (c) of the bill and is repeated in section 281 ("Rights of Users of Regulated Services") which ensures that users will have universal service and enjoy the benefits of competition as well.

The bill not only supports universal service in principle but it also incorporates specific provisions which will help achieve this objective. The provision of universal service is an economic problem. While the costs of delivering telecommunications services vary widely, existing institutional arrangements within the telephone industry provide for averaging of costs so that service can be affordable to the maximum possible number of persons. In some rural areas service will not, in the near term, be entirely self-supporting at rates which are low enough to be affordable. Thus, some form of economic support will be needed.

The bill addresses this problem by creating a National Telecommunications Fund which provides targeted assistance to certain exchange carriers which operate in areas where service, priced strictly upon cost, would not be affordable.

Three NTF "accounts" are provided for in the bill. NTF Account 1 (§234(b)(1)) provides revenue support to smaller exchange carriers to ensure that local ratepayers and carriers securing exchange access do not bear costs exceeding 110% of the national average.

NTF Account 2 (§234(c)) provides support for small exchange carriers to offset costs for rural connecting links which exceed 110% of the national average cost for connecting links. Finally, NTF Account 3 (§234(d)(1)) provides revenue support, which may be available to any exchange carrier, to avoid substantial or undue rate increases resulting from the implementation of cost related access fees.

In addition, the bill provides for continued regulation of carriers providing conventional message telephone service as well as other services for which there are no readily available substitutes. As part of this regulation, the Commission is given authority over discontinuance of regulated service by these carriers - authority which will continue to be needed until telecommunications services are available competitively throughout the United States.

IV. WHAT H.R. 5158 DOES NOT DO FOR ALASKA

H.R. 5158 partially replaces existing institutional arrangements for universal service by providing, through the NTF, economic support to certain exchange carriers which will permit them to maintain reasonable rates. However, this support is significantly lacking in one crucial respect. While the existing system, and previous proposed legislation (H.R. 6121), recognize that economic support must be available for both exchange and toll service, H.R. 5158 provides no support for toll services, regardless of need. All of the support derived under its provisions is paid to exchange carriers. While the State of Alaska supports fully the provision of a safety net for exchange services, the State also believes that support will be necessary under certain circumstances for toll services as well.

In Alaska the telephone exchanges serving bush communities are very small. Because these exchanges are small and because bush communities often have available few local goods and services, there is a much greater proportion of long distance calling from these exchanges than would be expected from rural exchanges generally. The fact that exchange service can be available at reasonable rates within these communities does not necessarily mean that they will enjoy effective access to the nationwide communications network. While economic support may force exchange rates to reasonable levels, the lack of economic support for toll service may make connection with the outside world unaffordable. Thus, notwithstanding the support mechanisms in H.R. 5158, universal service may not exist in the true sense. This situation is even more acute where Alaskan communities are served by a single telephone and where all calling is long-distance. The absence of economic support for toll services will effectively deny service to these communities.

The failure to provide toll support will likely mean that Alaska's rural telecommunications development will not advance beyond its present state. It is unlikely that interexchange carriers will extend service to these communities where the revenues to be derived at a reasonable rate level cannot cover the costs of extension of service. The result will be that universal service will not be achieved in Alaska.

Beyond this, certain other provisions of the bill may unintentionally work to interfere with the achievement of universal service in Alaska. Proposed changes are described below to address these issues.

V. CHANGES THAT SHOULD BE MADE IN H.R. 5158

Universal service does not exist in Alaska. This should be recognized in H.R. 5158. The bill should direct the Commission not only to "maintain" universal service, but to extend it to unserved areas as well. This extension and maintenance of universal service should encompass both exchange service and interexchange service as well. While section 101 makes clear that the Commission is to promote universal service, section 233(a)(6) provides that one of the purposes of the access charge system established under the bill is to:

> ...ensure the continued universal availability of telecommunications services provided by exchange carriers...(emphasis supplied).

Section 233(a)(6) should be amended to clarify that universal service does not now exist everywhere and that the goal of universal service shall embrace both exchange and interexchange services.

Certain changes should be made in the provisions establishing NTF Account 1. First, under the bill the entitlement for support established under NTF Account 1 is judged on an aggregate basis for an exchange carrier and its affiliates, taken as a whole. Since these affiliates may serve exchanges which are located in other areas of Alaska or the U.S. and since the costs incurred by these carriers in providing exchange service will no doubt vary widely, it is inappropriate to establish eligibility on an aggregate basis. Instead, eligibility should rest on whether an exchange carrier's costs, within a specified exchange, exceed 110% of the national average.

If eligibility is determined on an aggregate basis, an exchange carrier serving both high and low cost areas may have rates which are normal in one area, but which substantially exceed the national average in another. Such a carrier may not have the incentive or ability to raise rates in an exchange where costs are reasonable so that it may lower rates in an exchange where costs are exceedingly high. Not only would such an increase in rates likely be met with regulatory opposition in the State where the increase was proposed, but it would also constitute the kind of unstated subsidy which the access charge system was expressly created to avoid (see Section 233(a)(2)). For these reasons, section 234(b)(1) should be amended so that eligibility for NTF Account 1 funds will be determined on an exchange-by-exchange basis.

The Transitional Joint Board, and later the Commission, should be given greater flexibility in determining eligibility for NTF Account 1 funds. While it is appropriate to limit eligibility, by certification, to smaller carriers (those serving 50,000 or fewer main and equivalent stations), there should not be an arbitrary numerical limit placed upon the Board's authority to confer eligibility upon larger exchange carriers. Furthermore, as mentioned previously, affiliation with other carriers, which may serve differing areas with differing cost characteristics and service environments, should not be a factor in determining the eligibility of a rural exchange company for NTF funds. Thus, section 234(b)(3) should be amended accordingly.

NTF Account 2 provides funds to minimize disparities in charges for exchange service caused by the greater cost of connecting links to rural areas. While this account may provide relief to exchange carriers in certain instances, it will not be adequate in Alaska. The connecting link with many exchanges in rural Alaska is provided by satellite. These facilities are operated by an interexchange carrier. In many instances, where there is no rural exchange, this link connects a single village telephone with the remainder of the telecommunications network. While the costs of providing rural links to Alaska's smallest communities exceed the revenues which could be earned at reasonable rate levels, NTF Account 2 does not provide revenue support to make these services economically feasible.

The second account of the "National Telecommunications Pool" contained in H.R. 6121 was not so limited. That account would have provided support not only for rural exchange carriers but for rural interexchange carriers under certain conditions. The committee report accompanying H.R. 6121 specifically recognized that revenue support would be needed for interexchange services in Alaska:

> The toll NTP account provides that where long distance rates would exceed 110% of the national average

> because of these cost differences, the NTP would pick up the difference. The Committee is especially concerned about the continuing need to defray the cost of providing telephone service in Alaska and toll service to and from Alaska and Hawaii. The Committee intends that Account 2 be used to deal with those excessive costs in order to ensure that telephone service available in Alaska and Hawaii is comparable to that available in the contiguous 48 states. H.R. Rept. No. 1252, 96th Cong., 2d Sess. 78 (1980).

The circumstances in Alaska have not changed measurably since the Committee Report of 1980. For this reason, NTF Account 2 should extend eligibility to interexchange carriers under circumstances of demonstrated and historically recognized need.

While NTF Account 1 and NTF Account 3 each contain a specific funding mechanism, NTF Account 2 does not contain any such mechanism. For this reason a new subsection should be added establishing funding for NTF Account 2. The mechanism employed could be similar to that used in the existing bill for NTF Account 3 and an appropriate cross-reference should be added to section 233(c)(3).

With appropriate changes, H.R. 5158 should make possible the extension and maintenance of universal service in Alaska. Representatives of the State are available to assist in fashioning amendments to accomplish this objective.

Mr. WIRTH. Thank you very much, Mr. Hills.

Mr. McGill.

STATEMENT OF JOHN E. McGILL

Mr. McGILL. Thank you, Mr. Chairman.

My name is John E. McGill and I am vice president of Regulatory Affairs of Alascom, Inc., which is a mini-A.T. & T. Long Lines company serving the State of Alaska. We provide toll service through the State and have very few telephones as such. These are provided by our connecting companies, 26 local companies throughout the State.

I am also vice president for Telephone Utilities in Portland, Oreg., which serves seven Western States. My reason for being here today however is to discuss the special conditions in Alaska that make the State uniquely dependent on maintaining some support mechanism that will allow statewide long distance service at affordable rates. I appreciate the opportunity you have provided for me today to testify about H.R. 5158.

The crux of the Alaskan service problem is that the costs for serving Alaska are substantially higher than costs anywhere else in the country. It is interesting to note that at the time the Communications Act was originally drawn in 1934, the population density of the 48 States at that time was higher than the present density in the State of Alaska. The statewide density is less than one person per square mile in Alaska.

There are very few urban centers, and most of the communities in the State are very small. The cost of services are greatest when it comes to the remote, isolated bush villages, about 150 in number. Most of these cannot be reached by roads, as Mr. Hills explained.

Many can be reached only by air or by water during a brief season when ice does not close water routes. Of course, the whole State is also remote from the rest of the country. And, you are all aware of the severe climatic conditions in the country. These conditions make it difficult and expensive to serve Alaska. They also make Alaskans—and especially bush villagers—especially dependent on affordable and reliable communications to provide many of the necessities of life most Americans find close at hand.

Most Alaskans now can make long-distance calls. For inhabitants in the 100 bush villages we serve presently, there is one telephone in the village. They are required to stand in line to place calls for such critical services as medical supplies, supplies for their businesses, their equipment, machinery, for their snowmobiles, whatever it might be.

Long-distance rates are reasonably affordable now. When the company first took over the communications system in Alaska from the U.S. Air Force in 1970, the rates were substantially higher than equivalent rates for long-distance service in the lower 48. Through the urgings of the FCC and various joint board proceedings, the rates now are slightly less than 20-percent higher in certain rate bands, but the rates are much more affordable today than they were 10 years ago. That is, although Alaskan rate integration is not yet complete, it has already brought Alaskan MTS rates down to about 20-percent above the rates in the lower 48

States. It is our hope that ultimately we will achieve national rates. Because of nationwide rate averaging, the interstate settlements A.T. & T. pays to Alaskan carriers are more than 150 percent of the revenues from the service and we would expect that in the next 3 or 4 years this could reach 200 percent.

Because of the absence of support for toll service, State toll rates in the aggregate are higher in comparison to interstate rates in Alaska than in any other State. Even so, Alascom's rate of return for State toll is in the very low to negative range. Unless something like the present support is maintained, toll rates in Alaska must increase drastically. If competition also forces deaveraging within the State, the burden on customers in remote areas will increase still more. The result will be costs for long-distance calls that many Alaskans will be unable to pay.

The company commissioned a study by Stanford Research Institute to try to evaluate the cost to bring full telephone service to the remote areas of our State. We will submit this study to the record.[1] It shows that bringing home exchange telephone service and toll access to 158 Alaskan villages will require annual revenues of approximately $6,000 per main station for the facilities at bush locations alone.

The nationwide average, incidentally, is about $600 per main station. If the burden fell on our intrastate toll pool, the rates would have to increase by 63 percent throughout the State to accommodate the development of total communications in 158 small villages.

If bush villages had to bear the costs of service without substantial assistance from interstate or intrastate tolls, the local exchange rates for the villagers to get telephones in their homes would be in the range of $350 to $500 a month.

I have spoken primarily about bush service today because we have completed the study and we have the statistics which will support these conclusions. But the problem is not limited only to the bush areas of our State. It is an extremely high-cost area in which to provide long-distance telecommunications, and we are a long way from the lower 48. Unless H.R. 5158 is amended, it will do away with the present support for affordable Alaskan MTS and WATS service throughout the State. This is because the National Telecommunications Fund which is set forth in the bill limits eligibility to draw from this fund to local exchange companies.

As I explained, the long-distance carrier in Alaska is not a local exchange company. In addition, we do not yet know what impact the A.T. & T. antitrust settlement will have on payments we receive from A.T. & T. for toll service. If the payments are decreased, it will be a very serious matter for Alaska.

We have suggested amendments to the subcommittee staff to prevent drastic rate increases for basic Alaskan toll service and to make sure that Alaskan local exchange companies are eligible for the support they need. We are also concerned with the impact of H.R. 5158 on local and toll rates in general.

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[1] The study referred to "Telecommunications Alternatives for Rural Alaska: Commercial Feasibility and Social Benefits" by SRI International, Menlo Park, Calif., may be found in the subcommittee files or obtained from SRI.

For example, it seems to me that the benefits to be gained by encouraging the deaveraging of toll rates have not been shown to outweigh the loss to the nationwide system and to customers in rural and remote areas. We are concerned about the adverse impact on our local exchange operations in all the Western States we serve.

However, regardless of the national policy you choose, I must stress that the adverse impact on Alaskan rates and service will be extremely severe—worse than anywhere else—unless effective measures are adopted.

Thank you, Mr. Chairman.

Mr. **Wirth**. Thank you. Mr. Moreland.

STATEMENT OF A. JOSEPH MORELAND

Mr. **Moreland**. My name is Joseph Moreland. I am senior vice president of Anchorage Telephone Utility (ATU) of Anchorage, Alaska. I am pleased to be here today to testify on behalf of ATU regarding H.R. 5158, the "Telecommunications Act of 1981."

ATU is the largest local operating telephone company in the State of Alaska, providing service to more than 80,000 main stations in the municipality of Anchorage and surrounding areas.

ATU is also the largest municipally owned telephone company in the United States and the third largest local operating company not affiliated with a holding company.

In summary, ATU believes that any telecommunications legislation recommended by this subcommittee must include provisions which will: Permit telephone companies to fully recover their costs of embedded customer premises equipment (CPE) before embedded CPE is deregulated and/or removed from the rate base or separations process; establish a mechanism which will insure that there is no gap in the flow of revenues to local telephone companies from the provision of exchange access for long-distance carriers and the removal of CPE from local companies' rate bases. In other words, steps must be taken to make sure that there is no lag, in either time or dollar amounts, between current settlement payments and the payments to be made to local companies under the proposed access fee tariffs and from the National Telecommunications Fund (NTF). This will require that the NTF be in place, and have moneys available to disperse, before payments under the current system are reduced or eliminated; retain private sector control over the collection and distribution of the NTF, so that local companies will not be forced to incur new burdens and the added expense of dealing with a Federal regulatory agency in Washington; provide, as does H.R. 5158, that a local carrier should receive payments from the NTF when its costs of providing telephone service exceed the national average of such costs of 110 percent.

ATU believes that this cost-based approach is preferable to the average rate formula contemplated by S. 898; and not place the restrictions and obligations on independent telephone companies that will be imposed on the Bell operating companies under the proposed modification to the 1956 A.T. & T. consent decree.

I appreciate having the opportunity to appear and testify today on this important legislation and I would be pleased to answer any questions the committee or staff may have.

[Testimony resumes on p. 834.]

[Mr. Moreland's prepared statement follows:]

STATEMENT OF A. JOSEPH MORELAND, SENIOR VICE PRESIDENT, ANCHORAGE TELEPHONE UTILITY, BEFORE THE SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE OF THE HOUSE COMMITTEE ON ENERGY AND COMMERCE ON H.R. 5158

February 18, 1982

Mr. Chairman and members of the Subcommittee:

My name is A. Joseph Moreland. I am Senior Vice President of Anchorage Telephone Utility, ("ATU") of Anchorage, Alaska. I am pleased to be here today to testify on behalf of ATU regarding H.R. 5158, the "Telecommunications Act of 1981."

ATU is the largest local operating telephone company in the State of Alaska, providing service to more than 80,000 main stations in the Municipality of Anchorage and surrounding areas. ATU is also the largest municipally-owned telephone company in the United States and the third largest local operating company not affiliated with a holding company.

ATU interconnects with Alascom, Inc., the long distance carrier for Alaska, providing local exchange access for intrastate and interstate Message Telephone Service (MTS), interstate WATS, private line, foreign exchange, and tie-line services. ATU currently derives approximately 45 percent of its total revenues from the provision of exchange access for interexchange services through cost-based settlements with Alascom. These revenues are critical to the continued provision of high quality telephone service to the citizens of Anchorage.

The manner in which this Subcommittee resolves the issues now before it will affect the structure and the financial stability of all segments of the telecommunications industry for many years. These issues are extremely complicated, and their potential impact on both residential and business rate payers, and on exchange and interexchange carriers, is enormous. At stake is the continuation of the efficient, reasonably priced, nationwide telephone service currently enjoyed by 98 percent of the people in this country.

The overriding legislative objectives must be to improve the nation's telephone service, to ensure that both local and long-distance telephone service remain reasonably priced and affordable to the vast majority of U.S. citizens, and to reduce, not increase, Federal regulation of the telecommunications industry. H.R. 5158 is, in most respects, consistent with these goals. ATU believes, however, that several aspects of the bill will cause unintended problems, particularly for independent telephone companies, and need further study.

In summary, ATU believes that any telecommunications legislation recommended by this Subcommittee must include provisions which will:

-- permit telephone companies to fully recover their costs of embedded customer premises equipment ("CPE") before embedded CPE is deregulated and/or removed from the rate base or separations process;

-- establish a mechanism which will ensure that there is no gap in the flow of revenues to local telephone companies from the provision of exchange access for long-distance carriers and the removal of CPE from local companies' rate bases. In other words, steps must be taken to make sure that there is no lag, in either time or dollar amounts, between current settlement payments and the payments to be made to local companies under the proposed access fee tariffs and from the National Telecommunications Fund ("NTF"). This will require that the NTF be in place, and have monies available to disperse, before payments under the current system are reduced or eliminated;

-- retain private sector control over the collection and distribution of the NTF, so that local companies will not be forced to incur new burdens and the added expense of dealing with a Federal regulatory agency in Washington;

-- provide, as does H.R. 5158, that a local carrier should receive payments from the NTF when its costs of providing telephone service exceed the national average of such costs by 110 percent. ATU believes that this cost-based approach is preferable to the average rate formula contemplated by S. 898; and

-- not place the restrictions and obligations on independent telephone companies that will be imposed on the Bell Operating Companies under the proposed modification to the 1956 AT&T Consent Decree.

EMBEDDED TELEPHONE UTILITY EQUIPMENT

A key point with respect to the deregulation of customer premise equipment must be noted at the outset: The elimination of toll settlements on CPE will result in higher local basic telephone service rates. Presently, most telephone companies' local rates for CPE are at or above actual cost. This is before any consideration for toll settlements. The toll settlements received for this equipment are incorporated into the overall revenues of the utility and aid in keeping basic service rates down. With the deregulation of CPE, and the resulting loss of toll settlements, two things will occur: (1) local charges for CPE will rise or remain the same depending on market conditions (it is assumed that because competition in CPE exists today, present rate payers are sensitive to the level of their present rates for this equipment and no loss of customers will occur) and (2) local basic telephone service will cost more (because of lost toll separations support). There will not be an offset of lower terminal equipment rates and higher basic service rates, as some have alleged. In the case of ATU, the local basic service rates would have to rise approximately 33% to maintain existing revenue levels.

In addition, the reduction of regulated revenue sources to pay for embedded CPE costs should not occur until capital invested in CPE has been fully recovered. Companies should be allowed to fully recover their costs associated with the provision of CPE until the equipment is removed from regulation and the capital investment associated with the equipment is fully recovered from the toll and local services using that equipment. Telephone companies, regardless of their ownership characteristics, are just like any other businesses. They make investments based on certain assumptions; they assume sources of revenue from both local and toll; and they assume they have the ability to recover that investment and the opportunity to earn a fair return. They have assumed that regulation would provide them with a relatively stable environment in which to earn that return. It is ATU's position that this Subcommittee should not, through legislation, alter the conditions under which telephone companies have invested significant amounts of capital, without simultaneously providing a means for those companies to recover investments made in reliance on the current regulatory system. ATU strongly urges that the legislation provide for full recovery of the cost of embedded CPE before deregulation. Additionally, a mechanism must be in place to offset declining toll separations through this transition period for capital recovery, to mitigate the upward pressures that would otherwise affect local rates.

NATIONAL TELECOMMUNICATIONS FUND

We commend the House for its recognition of the upward pressures that have been and will continue to be applied to local rates. If universal service is to be preserved in all areas of the United States, some means must be devised to alleviate these pressures. H.R. 5158 would address this objective through the establishment of a National Telecommunications Fund ("NTF").

Under H.R. 5158, payments from the NTF would be made if a carrier's aggregate costs for the distribution of interexchange and exchange service per main station exceed 110 percent of the national average of such costs. In contrast, under the bill passed by the Senate, S. 898, payments will be made only when a carrier's rates exceed 110 percent of the national average. However, neither of these standards would achieve the objectives of the NTF unless access charges are set at a level which compensates the local operating company for a substantial portion of its costs. In ATU's view, the cost standard in H.R. 5158 is probably logistically preferable to the rate standard in S. 898 because methods for determining the aggregate cost of exchange distribution services are somewhat easier to apply consistently than those for determining average rate levels.

ATU believes, however, that the standards of eligibility for payments from the NTF contained in H.R. 5158 are inappropriate. They may leave many areas, including Anchorage, which have relatively high costs, ineligible to receive funds. Although ATU currently has approximately 80,000 main stations and thus could be eligible under the special waiver provisions of the bill, we have been growing at about 15 percent per year. With this level of growth, ATU would soon become ineligible for NTF payments under the bill. This would occur in spite of the fact that the cost of constructing telephone plant is very high in Alaska due to extreme weather conditions and high labor costs. Further, the costs of constructing the additional plant to meet this growth will be even greater than the cost of existing plant, thereby raising the average cost per customer. This would create the anomalous situation where, as ATU's costs per main station increase, the relative level of funding available would decrease. We believe the eligibility standards for payments from the NTF should be modified to recognize these situations.

ATU also has concerns regarding the administration of the NTF payments. If it is to be administered by the FCC, then both the costs of dealing with the FCC and the risk of untimely payments may severely harm the financial position of the utilities qualifying for NTF payments. Time and distance would make it very expensive for independents to file, support, and discuss cost study results with a Federal agency located in Washington, D.C. Most local exchange companies do not now file with the FCC for any purpose. All filings, both regulatory and separations, are made locally with the appropriate entities. H.R. 5158 would cause new and extensive filings with Federal regulatory bodies. Additionally, the sheer volume of filings would require substantial increases in the size of the Federal regulatory staff. We feel that each company should be required to interact only with its connecting carrier on these matters and only the predominant carriers should be required to support its jurisdiction's costs with the FCC. We strongly urge that the task of administering the NTF be left to the private sector, as is now the case under the current separations and settlements process. This will minimize additional new regulatory burdens and costs that would otherwise be placed upon local exchange companies.

It is also unclear to us just how we would receive payments from the NTF and how amounts paid prior to final study analysis will be determined. Presently, ATU receives a proportionate share of its current costs in toll settlements. These amounts are adjusted for any significant changes in levels of costs. Any significant lag in the receipt of this cost reimbursement would present severe financial problems to ATU. The amounts to be paid from the NTF should reflect current levels of cost.

THE JOINT COST ALLOCATION ISSUE

The resolution of the issue of joint cost allocation in the telephone industry will affect the cost and availability of telecommunications services to all ratepayers, both large and small, for years to come. Thus, full and careful consideration must be given to the social and economic effects of any legislative proposal in this area. The issues involved do not lend themselves.to easy or straightforward resolution. In most cases, there is no "right" answer to the questions raised, only possible approaches. Economic principles must be balanced with social policy, legal, and equity concerns to achieve a result that will serve the public interest in continued availability of telephone service at reasonable rates for the majority of the populace of this country.

Because of the importance of ensuring that the legislation resulting from this hearing is based on appropriate criteria, I would like to address two prevalent misconceptions regarding the allocation of jointly used telephone plant. The first misconception is that there is an economically correct or truly "cost based" method for allocation of jointly used facilities. On the contrary, any allocation method in these circumstances is inherently arbitrary. In terms of the actual service purchased in making toll or local telephone calls, it is impossible to precisely determine the portions of the "actual cost" of the joint facilities used in providing each service.

The second misconception is that any one allocation methodology, for example, Subscriber Line Usage (SLU), will foster competition in the telecommunications industry. This misconception follows from the first misconception that there is a truly cost based method for the allocation of jointly used facilities and the standard economic principle that in a competitive market, prices will equal marginal costs. Although ATU supports efforts to promote competition in the interexchange market, the adoption of the use of SLU will not lead to this result. In ATU's view, the only procedure which will allow true competition to take place is the uniform application of an allocation methodology to all competitive services. All competitors who receive similar access to exchange facilities should do so on the same financial terms. The claim that toll must be "deloaded" to achieve competition is inconsistent with the operational and financial characteristics of the exchange network, as well as long established social and regulatory policies. Competition will be ensured regardless of the level of access charges if each interexchange carrier pays the same access charge for comparable services to the local exchange carrier for the use of that local carrier's services and facilities.

The impetus for considering legislative and/or regulatory changes to modify the existing separations procedures has stemmed from the expressed views of some members of the telecommunications industry that the existing procedures are not cost-based and assign an excessive portion of exchange costs to interexchange services. This, it is claimed, leads to a subsidy of local exchange rates and gives false price signals to consumers. In so doing, the development of competition in the market for interexchange transmission services is supposedly inhibited because, for a truly competitive market, prices for services must equal the marginal cost of providing them.

ATU believes that this line of reasoning is seriously flawed because this theory assumes that the actual cost of the use of exchange facilities in providing access to interexchange services is determinable. And, to complicate matters further, it appears to assume that the marginal costs of this use are also determinable. Plainly, however, the attempt to isolate the "actual" or marginal cost of exchange access is an illusory exercise. There is nothing in either economic or cost accounting literature or practice to support the notion that the actual cost of each service using joint facilities can be determined by any allocation (or other) procedure. Any allocation procedure employed under these circumstances generates a purely arbitrary assignment of cost to services.

The recently announced settlement of antitrust litigation between AT&T and the Department of Justice, resulting in a proposed modification to the 1956 AT&T Consent Decree, raises several other issues which concern the independent telephone industry. First, the restrictions and obligations imposed on the Bell Operating Companies ("BOC's") under the proposed modification to the Consent Decree should not, under any circumstances, be applied to the independent telephone industry. To do so would result in immediate severe economic injury and the loss of the opportunity for local operating companies to maintain their viability through the provision of regulated services as well as unregulated services and equipment. As I have already stated, the removal of CPE from the rate base of local companies would have a significant impact upon revenues and, in the case of ATU, would result in upward pressure on local rates of approximately 33%. Under the proposed modification to the 1956 Consent Decree, the BOC's will no longer have ownership of CPE. Thus, not only does there exist the potential for pressure to increase local rates because of the removal of CPE from the rate base and the loss of ownership, but there is also the unanswered question of who will actually provide CPE to subscribers in the less desirable local exchange markets. Secondly, under the proposed modification, it is unclear whether the BOC's would retain the right to publish the Yellow Pages. The loss of this source of revenue for local companies would be disastrous and add even more to the pressure to increase local rates. The loss of this source of revenue to ATU would result in a need to increase local rates by 30%. Finally, it is unclear under the proposed modification just how the costs on which access charges are to be based will be developed since, as I have already suggested, there is no true method for allocating jointly used equipment in the provision of exchange and interexchange services. In the final analysis, legislation should consider these issues which concern the independents.

I appreciate having had the opportunity to appear and testify today on this important legislation, and I will be pleased to answer any questions that members of the Subcommittee or its staff may have.

Mr. WIRTH. Fine. Thank you very much.

Mr. Swift.

Mr. SWIFT. My State of Washington, the State of Alaska, have a long history of being allies in a good many battles. Perhaps being the gateway to Alaska, we recognize some of the unique problems you have. I would appreciate it if you could elaborate a bit on how in fact your service there differs so markedly from what we in the lower 48 would assume to be telephone service.

For example, it sounds to me that the term local exchange and long-distance really in fact mean something very different in Alaska than they mean down here. Could you elaborate on that a little bit, Mr. Hills?

Mr. HILLS. Yes, sir, maybe I could start. I think the first thing that occurs to me is the way in which long-distance calling is used in our remote communities, and the fact that a long-distance call is frequently used by someone in a village, for example, in the same way that a local call might be used in the city.

That is, in connection with essential services which are in a formal situation, closer at hand.

Mr. SWIFT. If that village has got one phone in it, that certainly does not constitute a local exchange, does it?

Mr. HILLS. No, sir. Some of our villages have one telephone at the present time. Others have exchanges. In either case, and normally speaking, a call which is placed to another community is a long-distance call.

Mr. SWIFT. Who then operates that one phone or the two or three phones in a community? Is that the long-distance company?

Mr. HILLS. Yes.

Mr. SWIFT. So, that the long-distance company is kind of a super-exchange in a sense, is that correct? You normally think of a telephone being in a local exchange and somewhere that connects to a long-distance system. Here it seems to me that you pick up a phone and you are in the long-distance system, no local exchange at all.

Mr. MCGILL. Exactly. You pick up the phone, you get a dial tone from Anchorage. The call is then routed and could be going back to a village 150 miles away from the calling village. The call travels via satellite from the one phone on the country store wall, or the community center, through the satellite, into Anchorage. It is timed and ticketed, it is set up, and it is retransmitted via satellite out to another village.

So, in a sense it is like a local call only it travels over a tremendous distance.

Mr. SWIFT. Do you have problems sometimes in Alaska deciding what is your jurisdiction and what is your jurisdiction, Mr. Moreland?

Mr. MORELAND. No.

Mr. SWIFT. It is pretty obvious what is a reasonable local exchange and what is the kind of unusual situation Mr. McGill is describing?

Mr. MORELAND. Yes.

Mr. HILLS. Our communities tend to be, even in the bush, our people tend to be concentrated into villages. That is, we have clusters of people called villages or small communities which are themselves separated by great distances, so that exchange boundaries become clear.

We might continue on, if you like, to tell you about the local exchange development which goes on from the single telephone scenario which is the direction in which we are heading.

A number of small companies and cooperatives have received certification from the Alaska Public Utilities Commission to provide exchange services within those small communities. The situation then becomes that that company interconnect with Alascom. Alascom then takes on the more traditional role of a long distance carrier and a separate company serving as the local exchange carrier. Even in that situation, though, long distance calling has the same character I described earlier with respect to essential services.

Mr. SWIFT. Mr. McGill, you indicated about 60 percent of your revenue comes from separations and settlements, you used 150 percent.

Mr. McGILL. What I was alluding to there is the amount of revenue generated by interstate calling to and from the State of Alaska. We require in settlements 150 percent of that amount. So, the total revenues generated at the present levels for toll service in and out of Alaska are less than the amount of money required under the Ozark cost settlements we use to settle with Bell. A.T. & T., in other words, pays us $1.50 for each dollar of revenue generated.

Mr. SWIFT. How much is the separations and settlements contribution of your total revenue?

Mr. McGILL. Our total revenues last year were approximately $265 to $270 million. The interstate toll settlement contribution to that amount was $191 million. Now of that $191 million we then distribute $93 million to those companies who provide the local exchange service settlements. It flows right through us. ATU gets the major portion of it, being the largest company in Alaska.

Mr. SWIFT. What portion of your total revenues come from separations and settlements?

Mr. MORELAND. Approximately 45 percent.

Mr. SWIFT. Forty-five percent. What specific changes do you think need to occur in the bill we are considering, 5158, in order to assure your survival in a fashion that you deem appropriate?

Mr. MORELAND. We have a couple of concerns.

One is the recovery of capital if we are going to remove or deregulate a portion of our investment, which would be CPE. There are two things that have to occur. One is recovery of capital. The other is to mitigate the impact of loss of separations on that equipment.

Right now, CPE, as with most independent companies, is tariffed at the local level at 100 percent of cost without consideration for the separations. In other words, the separation goes into the general revenue funds of the utility, which are then considered for rate cases.

So, in fact, they have a tendency to reduce the local basic service rates and have no direct impact on the cost of the CPE. So, when we remove the CPE for ATU to recover the revenues from the separations process, we would have to increase the basic local service rates by approximately 33 percent just to recover the separations moneys lost from CPE.

Mr. **Swift**. What would an average telephone bill for a residential customer in Anchorage be?

Mr. **Moreland**. It would run somewhere from $10 to $18.

Mr. **Swift**. So that could go to 13 to 24 bucks?

Mr. **Moreland**. Right, just by that one. Of course there are many others contemplated. The conversion from SPF to SLU would require over a 200 percent increase on the local basic service rates.

So, there is a lot of things pending. They all compound the problem.

Mr. **Swift**. Do you think there is anything that can be done with SPF to SLU so you don't maybe have to go all the way to SLU, but you can move in its direction from SPF?

Mr. **Moreland**. Yes.

Mr. **Swift**. Is that a realistic thing? We tend to talk about those in either/or relationships.

Mr. **Moreland**. Yes. We have made filings on docket 8286 regarding this. We have proposed plans which we call the calling capability factor plan, because we believe, and I have stated so in our written testimony here, that it is ambiguous to try to say that there is an actual cost based method of allocating joint use facilities based on usage, when in fact the investment and use of those facilities has no relationship whatever to the usage.

In other words, they are consumed on a time basis, regardless of if they are never used or are used 24 hours a day. What we are proposing is that a substitute factor be utilized in place of SLU that would base that criteria on the capability of the customer to access different types of functions, local, MTS, interconnect, F, X, whatever they chose.

Mr. **Swift**. Could you provide me with information on those proposals?

Mr. **Moreland**. Yes, I can give you our submissions.

Mr. **Swift**. Any comments on that from either of the other gentlemen?

Mr. **Hills**. I can comment if you like on the specifics that the State is proposing.

Mr. **Swift**. Please.

Mr. **Hills**. Our suggestions are more attuned to fine tuning the legislation as it is presently written.

Mr. **Swift**. Fine tuning H.R. 5158?

Mr. **Hills**. Yes, sir. As I said in my direct testimony, our No. 1 concern relates to the interexchange, or total service. And we proposed that some assistance be added that would help to maintain those rates at reasonable levels.

Our feeling is that the 234C account, which pertains to rural connecting links, either is not applicable to some of our situations in the State, or may not be applicable, depending on how it is interpreted.

To be specific about that, John McGill earlier described how a toll call from a rural community is routed through an Earth station to a major Earth station outside Anchorage, switched in Anchorage, back through the major Earth station, back through the smaller Earth station. We don't have a high degree of confidence that that could all be interpreted as a rural connecting link within the meaning of the legislation as it is written right now.

So, that is our number one concern. We are also suggesting a funding mechanism be added to that 234C account, which seems to be missing in the draft of the bill we have right now.

In the 234B account, we are suggesting that eligibility for that assistance be determined on an exchange-by-exchange basis, rather than on an aggregated basis. We have some companies, for example, that have operations outside the States. As we read the 5158, those operations would all be aggregated for the purpose of computing this assistance. If the determination were not made, were not required to be made on an exchange-by-exchange basis, the wording might be at least permissive, and allow the determination to be made in that fashion rather than on an aggregate basis.

Mr. SWIFT. Mr. McGill, did you have any comment?

Mr. MCGILL. No, I think I would agree with Mr. Hills. Certainly, some sort of support mechanism for the interexchange carriers in Alaska is very critical to us in order that we can continue to pay adequate settlements or access charges to our local companies, not corporately ours, but those that we cooperate with in delivering service. And also the limitation on main stations. If you were sitting in Washington there are some places you would describe as villages. If you were sitting in the village you would describe it as a city.

For example, Bethel, which is served by General Telephone, which obviously has well in excess of the 50,000 main station limit that is placed on drawing from the surcharge pool. Yet, their needs are just as great as many other areas that have smaller numbers of main stations. So that is an area. I am not sure exactly what the fix is, but I think it is a problem area in the State of Alaska.

And I would think for Mr. Moreland, who is with the only telephone company in the State in excess of 50,000, by itself. There are others which exceed that by aggregating with other held companies.

Mr. SWIFT. Thank you very much.

Mr. WIRTH. Thank you, Mr. Swift.

Mr. McGill, are there any competitors to Alascom?

Mr. MCGILL. Presently there are none.

Mr. WIRTH. You say presently there are none.

Mr. MCGILL. The reason I phrase it that way, we frequently are asked to bid on various Government contracts. And in those arrangements, generally it is always for private line service applications of one type or another.

Mr. WIRTH. Have any competitors suggested they are interested in coming into Alaska?

Mr. MCGILL. Yes, there are three or four that have already filed.

Mr. WIRTH. If we develop the subsidy program that you are talking about to Alascom, how would that then insure on the one hand either the universal service you are talking about, or on the other hand the agreed upon goal of creating a competitive environment?

How can the people who file to come into Alaska compete if you are being subsidized as you have suggested?

Mr. MCGILL. Well, I think in general terms, normally the competition would be coming in in a very nonuniversal sense. They would be coming to serve, as I indicated in my testimony, two or three of the areas in the State: Juneau, Fairbanks, Anchorage, possibly Ketchikan. But there are not enough population centers to draw them into other areas of the State, although we are required, in the terminology of the earlier panel, to act as the provider of last resort.

We have to serve all of the rural areas. Now it is quite evident to us that if competition were allowed freely to come into the State, that that would put very severe pressures on us in the provision of service to the remote areas.

Mr. SWIFT. Would the gentleman yield on that point?

Mr. WIRTH. Yes.

Mr. SWIFT. Is this getting back to the old cream skimming argument? In other words, you are required to provide the service and are you saying your concern is that the competitors go into the lucrative areas and leave you holding all the expensive ones, is that what you are saying?

Mr. MCGILL. Well, a competitor could come in and offer an alternate toll-type service, or get into private-line pricing which would be considerably lower than ours. The only way we can meet that threat presumably would be to reduce our rates to compete. If we did that, obviously, our revenues go down and it creates a much greater pressure in the provision of service to villages in the Brooks Range, or along the Seward Peninsula.

Mr. WIRTH. Would those competitors pay an access charge for plugging into the Anchorage system?

Mr. MORELAND. Yes, they would.

Mr. WIRTH. Does Mr. McGill's operation pay that same fee?

Mr. MORELAND. Yes, we currently have an access charge on file comparable to revenues we derive from separations. So theoretically it is an equitable charge.

Mr. WIRTH. So there would not be the kind of cream skimming Mr. McGill thought. Would everybody pay the same access coming into Anchorage?

Mr. MORELAND. I think Mr. McGill is addressing a different problem. As far as Anchorage is concerned, they would pay an access charge for the locality. But Anchorage and possibly one or two other cities are the only ones in the State of Alaska that probably anyone would be interested in accessing.

Mr. WIRTH. But there is no real cream skimming argument if everybody is paying the same access charge, plugging into Juneau or Anchorage. Where is the cream skimming?

Mr. MORELAND. I think he is referring to the fact he is receiving more than his cost from A.T. & T. for providing that Long Lines line.

Mr. SWIFT. If the gentleman would yield, the term cream skimming was mine. I do not want to saddle Mr. McGill with defending a point I brought up, and maybe put words in his mouth. What I was getting at is you made the point that you are required to provide service. What I was wondering is, is your concern that competition may be able to come in and pick and choose where it will serve, or would it have to come in and provide service in effect on demand as you do?

Mr. MCGILL. I am certain that they would pick and choose. And I am certain there are many, many areas that they would not pick.

Mr. SWIFT. So how I was using the term "cream skimming" was that they could go in only to the market in which they felt they could underprice you and make a profit, leaving you to serve areas that you do not have any choice but to serve.

Mr. McGILL. Correct.

Mr. SWIFT. Which would be the less profitable areas.

Mr. McGILL. And that is how I understood your question.

Mr. SWIFT. I think the chairman was using it in a somewhat different sense.

Mr. HILLS. Mr. Chairman, the State may have a difference with Alascom with respect to the interexchange assistance. And that is that the State is not proposing that such assistance be limited to Alascom. As such, if that were the scenario, as I believe it is in the Senate bill 898 and in H.R. 6121, that such assistance would not then serve to deter competition, if that is a concern.

Mr. WIRTH. What investment has the State of Alaska made in its telecommunications system?

Mr. HILLS. The State has made an investment in a variety of systems which it, the State, operates, including rural television network and so on. With regard to facilities that are generally available to the public, the kinds of things we are talking about here, the State has approximately $4.5 million in investment in the 100 small Earth stations that were constructed some years ago to serve the villages. Those Earth stations are at the present time jointly owned by the State and by Alascom.

The FCC is to determine the ultimate ownership of those Earth stations. But in the meantime Alascom for all intents and purposes operates those Earth stations. The State's $4.5 million is not included in the rate base used for ratemaking purposes. So in a sense consumers get some benefit from that $4.5 million investment. Ultimate ownership of the Earth stations will be decided by the FCC and will be either Alascom, or the local exchange carriers which operate in those communities. The State has asked not to be the ultimate owner.

Mr. WIRTH. In your opening statement you were talking about the few miles of highways that exist in the State of Alaska and the fact that telecommunications really is the way in which the State is tied together. Is that a fair summary of what you were saying?

Mr. HILLS. Right.

Mr. WIRTH. How many miles of highways are there in Alaska?

Mr. HILLS. The figure I have is 2,200 miles of paved highways.

Mr. WIRTH. Not a very significant burden on the State government for maintaining highways as say, for example, in New England with its collapsing bridges and potholes?

Mr. HILLS. I do not have any dollar figures to present to you. I would suspect that our per highway mile burden is higher but I do not have any total figures for you.

Mr. SWIFT. Would you care to talk about the ferry system you have to operate?

Mr. HILLS. Yes, sir, the State government also operates a State ferry system which is called incidentally, the Alaska Marine Highway. It operates as an extension of the highway system and connects with the highway system.

Mr. **Wirth**. Are there any plans that the State has for investing in this communication infrastructure of the State, say, just as my State invests a great deal of money in highways?

Mr. **Hills**. Well, the State continues to invest in telecommunications facilities of its own use, that is, to enhance the delivery of State government services.

Mr. **Wirth**. Beyond that, for the general good of the people for whom the State government is responsible?

Mr. **Hills**. Beyond that I think the trend is very obviously toward private sector operation, and that is indicated, for example, by the State's withdrawal from contention for ownership of the Earth stations.

Mr. **Wirth**. So there are no plans for the State to invest any of its revenues in a communication system?

Mr. **Hills**. There are no plans at this time in that direction.

Mr. **Wirth**. Is there a limited amount of revenue in the State of Alaska at this point?

Mr. **Hills**. Yes, there is a limited amount, yes, sir.

Mr. **Wirth**. Compared to what?

Mr. **Hills**. There is recently some concern in State government that the oil revenues may not live up to the high levels that had been predicted at one time. And, in fact, there is a move afoot in the State legislature this year to trim budgets and to cut State operations. I am not sure if you are moving in the direction of suggesting that the State government provide the kind of assistance that we are talking about here. I can address that if you would like me do.

Mr. **Wirth**. I am just thinking about colleagues in Detroit or Cleveland or wherever, where they have States that are struggling like crazy to keep their heads above water and have enormous infrastructure investments that those States have to service. They have a unique set of problems. On the other hand, you have a unique set of problems, which is a different kind of communications network and different kind of infrastructure.

Most States in the Lower 48 are making very, very signficant investments in one kind of infrastructure. I just wondered if there is any parallel between the investments made by the State of Alaska and that which is made by States of the lower 48 to get some sense of equity in the obligations the State governments have to serve their people.

Clearly telecommunications becomes relatively more important in Alaska because of the distances that you talked about and highways and bridges become relatively less important. Waterway service becomes more important and interstate tunnels become less important.

Mr. **Hills**. Yes. Well, in a broader sense the State is making a substantial investment in telecommunications, and I mentioned earlier, for the purpose of enhancing its own function. I think the use of teleconferencing facilities which the State is involved in and I think will continue to be involved in in an increasing way to allow citizens to have input into the legislative process——

Mr. **Wirth**. But no investment has been made in terms of servicing the kinds of villages you all have been talking about and the lines of people who have to wait to make telephone calls. Has the State assumed any role there?

Mr. HILLS. Aside from the $4.5 million investment I mentioned, at the present time——

Mr. WIRTH. Which was made years ago?

Mr. HILLS. Which was made in about 1975? I am sure we do not want to foreclose that option. We are certainly familiar with the parallel that you drew a few minutes ago between highways and telecommunications for example. The approach that has always been used in the United States is that the nationwide telephone system supports itself as a nationwide network.

As you can see, that is the approach we have taken in our testimony. I think that the State would not want to foreclose the option of the State providing assistance if it turns out as these events run their course that the nationwide system does not support the nationwide system, at least not the nationwide system including Alaska.

So I think that that possibility is always there.

Mr. WIRTH. Every State has its own unique problems, we understand that. We try to create a nationwide system. It seems we are also justifiably concerned with the equities there, who is investing in what infrastructure. It would be helpful to get from you any comparative figures you might have on what sort of infrastructure investments are being made per capita.

Does that make sense?

Mr. HILLS. I would be happy to provide that.

Mr. WIRTH. We are getting into a discussion of asking basic telephone service in the country to subsidize rural Alaska, which I understand. We also are asking what other kinds of communication network infrastructure is being invested in by the State of Alaska. If I were a Congressman from Cleveland I would be asking that question. What are they doing? What are we doing? Where are the equities?

Mr. HILLS. We will be happy to provide that.

Mr. WIRTH. It would be helpful if you could.

Mr. HILLS. Our problem is really a more extreme version of the rural problem generally.

Mr. WIRTH. I understand that, with different spins on it given the nature of Alaska.

Gentlemen, thank you very much for being with us. We are delighted to have you here. We look forward to receiving back from you the material we discussed earlier and working with you on the development of this legislation.

The subcommittee will be in recess.

[The following statement was received for the record:]

Statement of

ROBERT M. WALP, PRESIDENT
GENERAL COMMUNICATION INCORPORATED
ON H. R. 5158

Presented to

SUBCOMMITTEE ON TELECOMMUNICATIONS
CONSUMER PROTECTION AND FINANCE

COMMITTEE ON ENERGY AND COMMERCE
U. S. HOUSE OF REPRESENTATIVES

February 18, 1982

General Communication Incorporated (GCI) is a common carrier recently authorized by the Federal Communications Commission to provide telecommunication services in the Alaska market. GCI is the first firm of its type to offer long lines voice and data communications as a competitive alternative to the existing monopoly carrier in Alaska. We are presently in the process of constructing our system and expect to initiate operations later this year.

The advent of open competition in telecommunications in the other states led to the formation of GCI and its program to offer alternative telecommunications in Alaska. We fully support the "Telecommunications Act of 1981" for its reliance upon competition rather than regulation, the encouragement of entry of new competitors and the stress on nondiscriminatory charges for regulated services.

Recognizing that certain segments of the industry, primarily the local exchanges, still display many features of a natural monopoly, H.R.5158 combines these less competitive features into the local exchange functions and mandates a strict regulatory structure. This structure is designed to guarantee the availability of essential services at affordable rates while at the same time fostering full and fair competition in interexchange services.

The proposed legislation appropriately refrains from both imposing detailed regulatory requirements, or bestowing subsidies, upon the competitive interexchange carriers. The intended result, which is consistent with the entire thrust of the bill, is that competitive interexchange carriers will respond solely to the needs and demands of the marketplace, and in doing so, will create an efficient and effective telecommunication system at the least possible cost to the consumer.

As this Committee is well aware, telecommunications in Alaska is burdened by the higher cost of exchange and interexchange services in Alaska. While part of this Alaska cost differential is attributable to the provision of service to small, remote communities in rural Alaska, the major portion of the difference results from the generally higher costs of doing business in Alaska; this includes substantially higher salaries which must be paid to attract Alaskan workers, higher transportation costs to and from the state because of its distance and isolation from the 48 contiguous states, and the longer average length of haul for telecommunication traffic to, from and within Alaska. These latter costs, of course, affect all Alaska telecommunication facilities and are the reason why the costs for both urban and rural telecommunications in Alaska exceed the average costs for comparable services in the rest of the United States.

As one of the fifty United States, Alaska is entitled to equal treatment under the "Telecommunications Act of 1981."

Alaskans should be able to procure adequate telecommunication services at reasonable rates while at the same time enjoying the benefits of new and alternative services, technological innovation and increased efficiency that free and fair competition will provide to residents of the 49 other states. This Committee and the Congress must be very careful that any "special" Alaskan provisions do not deprive the state of these benefits and impose upon it an inefficient and inferior communication system through anti-competitive subsidy mechanisms.

While GCI supports a subsidy mechanism which guarantees affordable telecommunication services throughout Alaska, it objects to any subsidies paid directly to interexchange carriers because they are inherently anti-competitive. The amendments to Section 234(c) proposed by Alascom are an example of such an anti-competitive mechanism, as they provide for subsidies "for interexchange services to, from and within Alaska that were subject to the system of jurisdictional separations and settlements in effect as of January 1, 1982 . . . ." Thus, these proposed amendments mandate a subsidy to be paid only to Alascom.[1/]

[1/] Alascom provided technical amendments to 233(c)(3) and 373(e)(4)(B) to provide for the funding of its proposed subsidy account. However, it did not provide technical amendments to Section 234(e)(2), (A), (B), and (C) which would make Alascom's subsidy payment, as all other subsidy payments under the Act, subject to audit and adjustment if it was not used to maintain reasonable rates, or if it removed incentives for efficient service or impeded the entry and operation of competitive suppliers.

Most important, and in direct contradiction to the intent of H.R.5158, Alascom's proposal creates a statutory bar to competitive telecommunication service to, from and within Alaska. As noted, the costs for Alaskan service exceed national average costs for comparable service. Thus, if Alascom is guaranteed a subsidy to keep its rates approximately equal to the national average, no other carrier will be able to penetrate the market without selling its service below costs. In sum, the proposed changes to 234(c) would legally vest Alascom with a monopoly position and guarantee its rate of return through a public subsidy; these are the very things the proposed legislation is designed to eliminate.2/

Although any subsidy scheme distorts the workings of the marketplace, there are alternatives which would be less anti-competitive than Alascom's proposal:

1. From a perspective of economic efficiency, the best approach would be to pay subsidies directly to the users of telecommunication services in a manner that allows them to choose freely among various providers. Implementation of this approach would not be difficult in view of current message accounting and billing practices. Further, questions regarding cross-subsidization between regulated and unregulated services would be substantially reduced or eliminated.

2/ Additionally, the proposed amendments would reduce incentives for Alascom to be efficient or technologically innovative. Although Alascom's rates would be maintained within 10 percent of the national average, its costs, and correspondingly the true social costs, would not be lowered by improved performance in response to competitive pressures.

2. A less direct alternative is to use an institutional representative of the individual consumers and subsidize users through that institution. This is the way the current bill structures the situation by providing subsidies to the regulated, non-competitive local exchange carriers. This same mechanism could be used to reduce interexchange costs by decreasing exchange access charges for interexchange traffic priced substantially above the national average. Exchange access charges could even be reduced to negative levels if required to keep interexchange services in an acceptable price range. Since access charges, including negative ones, would be applied on a non-discriminatory basis to all carriers accessing an exchange, the subsidy would flow to all interexchange carriers in proportion to the volume of traffic carried.

3. If a subsidy must be paid directly to an interexchange carrier, it should be through a subsidy bidding mechanism. Maximum allowable rates for certain routes would be established and carriers would bid to serve those routes for a specified period (less than five years) for the amounts to be earned from the commercial revenues plus a subsidy. The carrier bidding the lowest subsidy amount would receive a contract guaranteeing payment of that subsidy amount for providing service on the route during the designated period. Other carriers would be allowed to serve the same route but they would not receive any subsidy payments. Re-bidding the subsidy every several years would stimulate technological and operational efficiency by the subsidized carrier.

4. A less desirable alternative would be to expand the existing provisions of 234(c) to subsidization of exchange carriers, as opposed to interexchange carriers, for connecting links to and from rural and remote areas. An additional subsection under 234(c) could be added to allow isolated rural exchanges of less than 5,000 main stations to procure interconnection with the nationwide network, either by means of their own facilities or by facilities provided by an interexchange carrier, and to include the costs of such connecting links, even if it might

> otherwise be considered interexchange carriage, in the exchange costs which would be subject to subsidy from the account of the National Telecommunications Fund established under 234(c). [3/]
>
> While this scenario would not lower the charges for interexchange, it would provide protection to the remote rural areas of Alaska by guaranteeing them access to interexchange telecommunications at rates closely comparable to those available to consumers in the major Alaskan markets to which the remote exchanges would be linked.

Finally, in light of the rapid changes occurring in the telecommunications industry due to technology and competition, GCI believes the Congress might be advised not to specify a detailed structure for the operations of the National Telecommunications Fund. Rather, it may be better to lay out the principles guiding the establishment and implementation of such a fund while leaving the detailed mechanics of its structure and operation to the Commission. In this respect it may be better to establish 110 percent of national average cost as a guideline to be used by the Commission in ascertaining what reasonable costs for basic telecommunication services are rather than as an absolute mandate for price levels. The Commission should be left with some latitude for deciding cases where the anticompetitive effects of a strict 110 percent rule would be more injurious than a variation from that guideline.

[3/] In order to be consistent with the goals of the act it should be mandated that qualifying local exchange companies procure this connecting link in the most cost effective manner possible. Such procurement should be subject to review and revision by the Commission in the event that a more cost effective procompetitive structure is available.

[Whereupon, at 12:42 p.m., the hearing was adjourned.]

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